



Highlights and Analysis of the Governor's Budget

January 13, 2006
SENATE REPUBLICAN
FISCAL OFFICE



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Budget Briefs

SENATE REPUBLICAN FISCAL OFFICE

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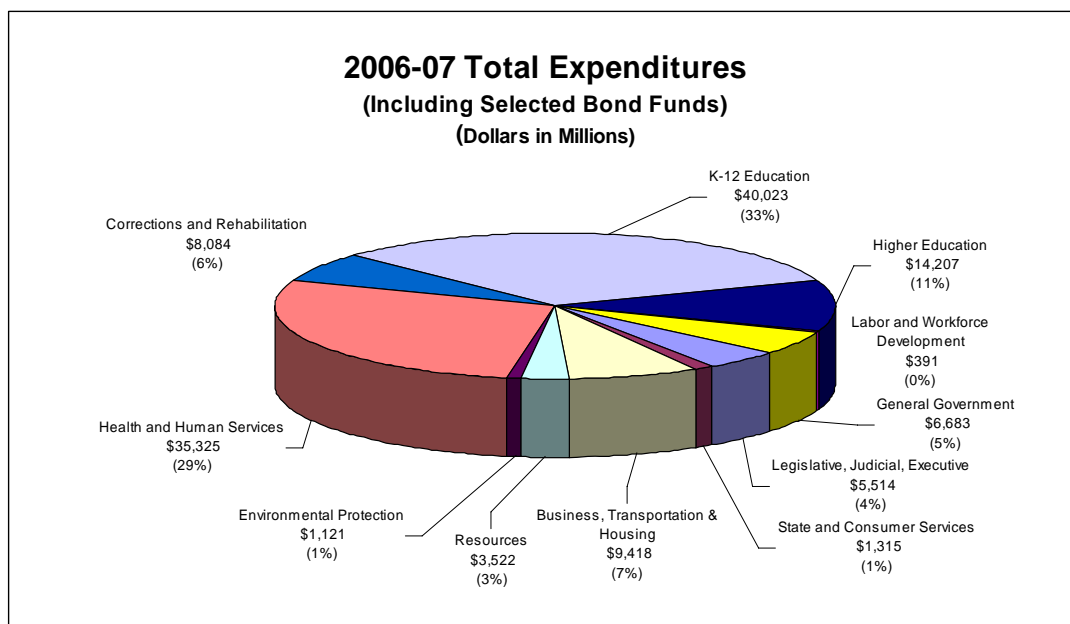
January 13, 2006

Executive Summary

The Governor's Budget for 2006-07 proposes total state spending of \$125.6 billion (Chart 1), \$97.9 billion of which is General Fund. General Fund spending is up \$7.9 billion from the level approved in the 2005-06 Budget Act, an 8.5-percent year-over-year increase. General Fund revenues are projected to be up \$4.3 billion (4.9 percent), and are augmented by an additional prior-year carryover of \$7 billion.

While the total proposed General Fund budget carries a \$613 million reserve in 2006-07, absent the \$7 billion carryover mentioned earlier, the Budget would be short about \$6 billion General Fund.

Chart 1



Budget Choices with Ongoing Implications. The Budget contains a number of augmentations that will increase the amount of ongoing General Fund needed in future years. The largest of these is a \$1.7 billion over-appropriation of the Proposition 98 Guarantee for 2006-07. This funding will be added to the base for calculating what is owed for schools in future years, and will result in a permanent need for additional General Fund resources.

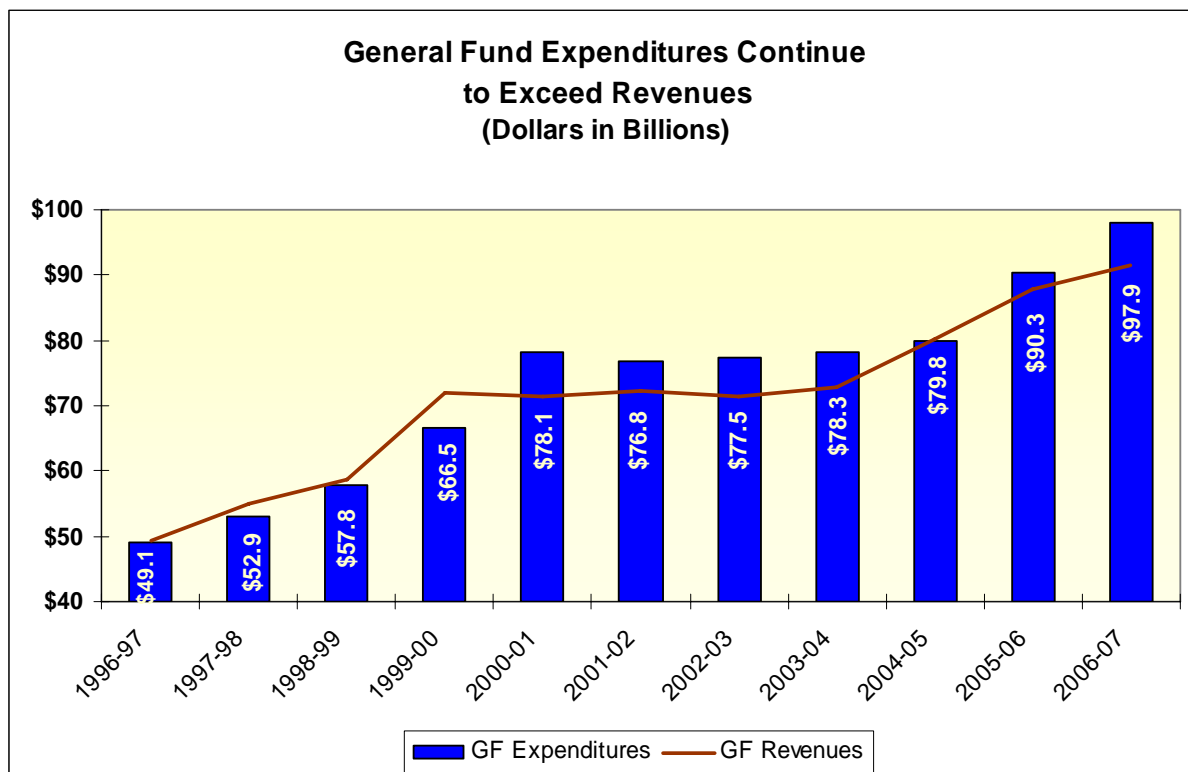
While the Budget does propose to provide the Governor with mid-year budget reduction authority, unlike previous years, the Budget does not contain significant reform proposals designed to reign in auto-pilot spending, nor does it contain meaningful programmatic changes that would result in reduced General Fund pressure.

Absent any budget corrections, current estimates show the structural deficit in 2006-07 to be \$6.4 billion, increasing to \$6.6 billion in 2007-08, and \$9.6 billion in 2008-09. Of course, these estimates also assume revenues continue to increase. Should California experience revenue declines, or worse, a recession, these structural deficit projections could increase significantly.

Chart 2 below shows the expenditure-to-revenue trends over the past several years. Except for fiscal year 2004-05, which is an exception to the rule largely due to unanticipated tax amnesty revenues, every year from 2000-01 through 2006-07 reflects General Fund expenditures that exceed General Fund revenues.

(Note: revenues for fiscal years 2002-03, 2003-04, and 2004-05 were supplemented by Economic Recovery Bond funds and Tobacco bond funds. Those revenue augmentations have been removed from the General Fund revenue line in the chart below to demonstrate a clearer discrepancy between General Fund revenues and expenditures.)

Chart 2



The Budget Provides Partial Payment of Outstanding Debt. By repaying \$920 million in outstanding Proposition 42 loans, and by providing an additional \$460 million in Economic Recovery Bond debt, the Governor's Budget does start to address some of the outstanding budget pressures facing the state.

The Budget Contains No New Taxes. This year's budget does not propose any new taxes. *However*, it does continue the suspension of the Teacher Tax Credit and the more stringent requirements of the Use Tax for an additional year.

The Budget Does Not Rely Upon Economic Recovery Bond Funds. In 2004, \$12.3 billion of the \$15 billion in available Proposition 57 bonding proceeds were used to pay off the accumulated budget deficits. The Budget retains the remaining \$3.7 billion in ERB capacity for future years, which seems prudent, given that the state is still spending more each year than it is taking in.

The Bottom Line. While the Budget does retain some of the tools that will help in future years, and makes some progress towards paying down outstanding obligations, it also *continues* to spend more than it takes in, perpetuating a structural deficit that will likely grow in the out-years.

Economic Outlook

The national and California economies experienced solid growth in 2005, despite considerable obstacles, including higher energy prices, rising mortgage rates, and tighter monetary policy. The California economy tracked the national economy, with job growth picking up, but personal income slightly lower. It is predicted that both the national and state economies will decelerate to some extent in 2006 and 2007, primarily the result of slower growth in homebuilding and increased consumer debt.

National: Continued But Slower Growth

National economic output for the first three quarters of 2005 was up 3.6 percent compared to last year. Consumer spending was the top contributor to the gain in national economic output, increasing \$282 billion (3.7 percent) when compared to last year. Gross private business investment was the second largest contributor to economic output growth, with a gain of \$107 billion (6 percent). Government spending also contributed \$36 billion to the gain in national output.

National job creation also improved in 2005, with a 1.6 percent year-over-year increase in non-farm payroll employment. Nationally, the top three categories of new jobs were construction, trade, and transportation.

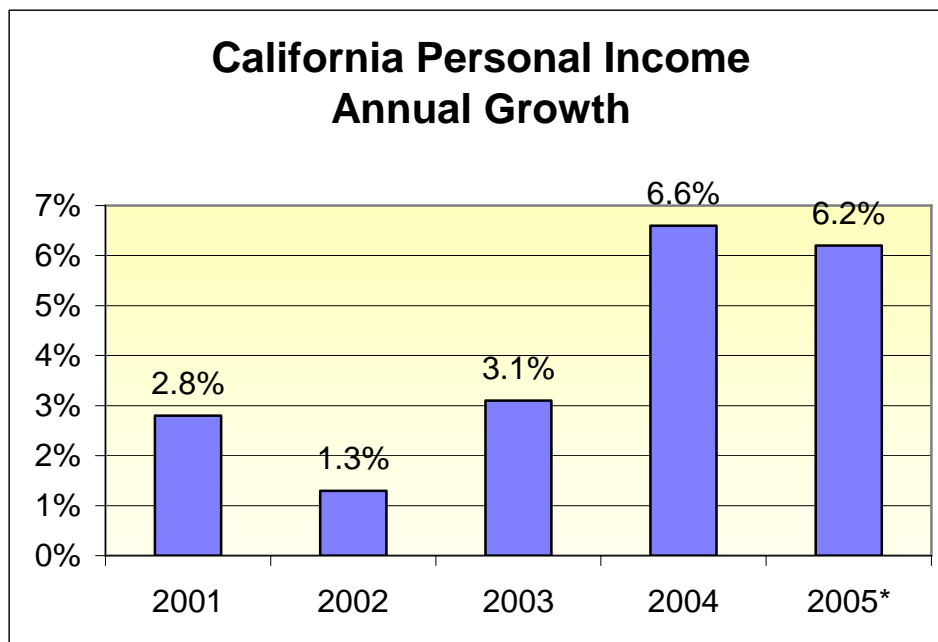
Prospectively, the national economy is predicted to grow, but at a somewhat slower rate, as consumer spending and residential construction decline somewhat, but are to an extent offset by continued growth in capital spending. Real Gross Domestic Product growth, which is estimated to have been 3.6 percent for 2005, is predicted to slow to 3.2 percent in 2006, and 3

percent in 2007. This reduction in growth is expected to result in slower job growth rates as well, with 1.5 percent estimated for 2006, and 1.3 percent for 2007.

California: Broad Economic Improvement Continues

The California economy also strengthened in 2005. Broad economic measures like personal income and taxable sales continued to gain, and exports of made-in California goods continued to increase, but not as fast as in 2004. Residential construction continued to expand, and perhaps most importantly, job growth resumed in the San Francisco Bay area.

Chart 3



**The 2005 figure is an estimate*

As shown in Chart 3 above, personal income - income received by California residents from all sources - was up 6.2 percent from a year earlier in the first three quarters of 2005. A year earlier, personal income was slightly higher at 6.6 percent. On this broad measure, the state is doing a little better than the nation, where personal income grew by 6 percent in the first three quarters of 2005. Personal income growth is expected to grow at a slightly slower rate in the next few years, expanding by 5.8 percent in 2006, and 5.5 percent in 2007.

Statewide taxable sales were up by 6 percent in the first half of 2005, slower than the impressive 9.1 percent rate in the first half of 2004. Made-in-California merchandise exports were 5 percent higher than a year earlier, with the biggest export gains going to Canada, Germany, and Mexico. While overall sales were up, high-tech exports fell by 2 percent after growing 15 percent the previous year.

California non-farm employment was 1.5 percent higher in the first 11 months of 2005. The state's unemployment rate also dropped from an average of 6.3 percent in the first 11 months of 2004, to 5.4 percent in the first 11 months of 2005. Comparatively, job growth in 2005 was reported to be better distributed across major industries as well as major regions of the state.

While home sales slowed in California in 2005, commercial real estate markets generally improved, with declining vacancy rates in many of the major metropolitan areas of the state. The strongest economic growth in 2006 is expected in the areas of professional and business services, leisure and hospitality, and private educational and health services. The state's unemployment rate is forecasted to average 5.1 percent in 2006, down slightly from 2005.

The state's economic fate is closely tied to the nation's. However, both are projected to be fundamentally sound, and are predicted to expand for several more years.

State General Fund Revenue Forecast

Table 1

2006-07 Revenue Sources				
(Dollars in Millions)				
	General Fund	Special Funds	Total	Change from 2005-06
Personal Income Tax	\$ 48,716	\$ 690	\$ 49,406	\$ 3,230
Sales Tax	28,295	4,719	33,014	1,366
Corporation Tax	10,024	0	10,024	403
Highway Users Taxes	0	3,483	3,483	85
Motor Vehicle Fees	22	5,243	5,265	174
Insurance Tax	2,340	0	2,340	94
Liquor Tax	316	0	316	1
Tobacco Taxes	118	978	1,096	31
Other	1,714	9,505	11,219	(1,392)
Total	\$ 91,545	\$ 24,618	\$ 116,163	\$ 3,992

Current forecasts show continued revenue growth in 2006 and 2007. As seen in Table 1 above, total General Fund resources are \$91.5 billion in 2006-07, an increase of \$3.9 billion when compared to 2005-06. This \$91.5 billion total has already taken into account a proposed \$460 million reduction associated with payment of Economic Recovery Bond debt. Including the \$460 million in the total above would bring General Fund revenues up to \$92 billion. Revenue increases include gains in the three major state taxes: personal income tax; sales tax; and corporation tax.

General Fund revenues and transfers represent 79 percent of total state revenue. The estimate of General Fund revenue for 2005-06 includes the following main components:

- **Personal Income Tax (PIT).** PIT revenues provide 53 percent of all General Fund revenues, and are forecasted to increase to \$48.7 billion in 2006-07, up 7.1 percent from \$45.5 billion in 2004-05. Current PIT forecasts assume capital gains increases of 20 percent in 2005 and 5 percent in 2006, after increasing an estimated 59 percent in 2004 and 34 percent in 2003. (These percentages compare to the reduction of 30 percent in 2002 and 57 percent in 2001.) The PIT is a very progressive tax: the top 12 percent of state taxpayers in 2003 (those with adjusted gross incomes over \$100,000) paid 76 percent of the PIT.
- **Sales & Use Tax (SUT).** SUT revenues provide 31 percent of all General Fund revenues, and are forecasted to increase to \$28.3 billion in 2006-07, up 4.1 percent

from \$27.2 billion in 2005-06. Taxable sales grew by an estimated 5.3 percent in the first three quarters of 2005, and are expected to continue to increase by 4.9 percent in 2006 and 5 percent in 2007. Although SUT receipts are most generally associated with retail spending, approximately one-third of taxable sales are attributable to business-to-business transactions. These include purchases of computers, telecommunications equipment, and building materials that go into the construction of new facilities.

- **Corporation Tax (CT).** CT revenues provide 11 percent of all General Fund revenues, and are forecasted to increase to \$10 billion in 2006-07, up 4.2 percent from \$9.6 billion in 2005-06. This estimate reflects the strong corporate tax profits in 2005.

Economic Recovery Bonds (ERBs). The Budget does not assume the use of ERBs, retaining the remaining approximately \$3.7 billion in ERB authority for future use.

Reserve for Economic Uncertainty. The Budget assumes an ending reserve for the 2005-06 fiscal year of \$6.5 billion and a year-end reserve of \$613 million for fiscal year 2006-07.

Tax Issues

The Governor's proposed 2005-06 Budget contains ***no new tax increases***. ***However***, it does continue the suspension of the Teacher Tax Credit and the more stringent requirements of the Use Tax for an additional year, which, when combined with several other smaller proposals, total \$252 million.

In 2005 several revenue generating measures were enacted. The Budget includes revenues in 2006-07 derived from continuing both the suspension of the teacher tax credit and increased collection of the use tax on luxury vessels for an additional year. It also anticipates increases in collection of the sales and use tax (resulting from additional information obtained at agricultural inspection stations), and increased cigarette and tobacco tax collections, resulting from enhanced enforcement of internet and mail order sales of cigarettes. Finally, the Budget assumes an \$8 million loss associated with state conformity with the establishment of federal Health Savings Accounts (HSAs).

2006-07 Revenue Issues Summary of Fiscal Impact (Dollars in millions)	
<u>Description</u>	<u>Fiscal Impact</u>
Teacher tax credit: one-year suspension	\$210.0
Increased sales and use tax collection	14.0
Vehicle, vessel, and aircraft use tax (sunsets July 1, 2007)	35.0
Increased cigarette and tobacco tax collection	1.3
Conformity with federal Health Savings Accounts (HSAs)	(8.0)
Total	\$252.3

Note: the luxury use tax revenues may be overstated as a change in behavior of the owners might occur or negatively impact the industry. We look forward to the Legislative Analysts' report of the impact of the tax which is due this year.

Education

Proposition 98 Funding Rises by \$4.3 Billion. For 2006-07, the Governor proposes to increase Proposition 98 appropriations by 8.7 percent (\$4.3 billion), to \$54.3 billion, roughly the same percentage increase as the overall Budget. The \$4.3 billion increase includes \$2.2 billion to meet the minimum guarantee, and an over appropriation of \$2.1 billion (\$1.67 billion of which is discretionary, and the remainder of which is required by Proposition 49 to bring total funding for after school programs up to \$550 million). As a result of these increases, both Proposition 98 and total per-pupil funding rise significantly, as shown in the following table:

Prop. 98 Total and Per-Pupil Funding Grow Substantially					
(Dollars in thousands)					
	2005-06	2006-07	Difference		
General Fund	\$36,310,868	\$40,455,466	\$4,144,598		11.4%
Local property taxes	<u>\$13,675,107</u>	<u>\$13,862,487</u>	<u>\$187,380</u>		1.4%
Total	\$49,985,975	\$54,317,953	\$4,331,978		8.7%
(Actual \$)					
K-12 Prop. 98 per-pupil funding	\$7,428	\$8,052	\$624		8.4%
K-12 total per-pupil funding	\$10,336	\$10,996	\$660		6.4%

The Governor proposes to spend the \$1.67 billion over appropriation for the following:

- **\$565 million to fully fund K-12 growth and COLA** (total of \$2.3 billion).
- **\$200 million for K-12 revenue limit equalization**, which is roughly half of the amount required to reach full equalization.
- **\$200 million to reduce the deficit factor** for school districts and \$5.1 million to reduce the deficit factor for county offices of education.
- **\$133 million to reimburse K-12 schools for the cost of education mandates**, which have in recent years been “deferred”.
- **\$130 million for community college revenue limit equalization**, which is roughly the amount needed to achieve full equalization.
- **\$100 million for arts/music block grants** for K-8 students.
- **\$100 million for teacher recruitment and retainment** in low-decile schools.
- **\$85 million to expand physical education** and fight childhood obesity (\$60 million for block grants to hire staff, pay for professional development, and buy equipment, and \$25 million for matching grants to hire more qualified teachers).
- **\$65 million** to expand the Beginning Teacher Support and Assessment (BTSA) **professional development** program in low-decile schools.
- **\$30 million to expand career technical (vocational) programs** to a total of \$50 million. These funds will flow through the Community Colleges’ budget.

- **\$25 million for education technology** block grants.
- **\$20 million** to support students who are struggling to pass the **high school exit exam**.
- **\$18 million** for the California Fresh Start Pilot Program (Chapter 236, Statutes of 2005), to promote the consumption of **fruits and vegetables** by K-12 students.
- **\$9.6 million** for service to **Community College disabled students**.
- **\$1.1 million** to restore categorical funding to **basic aid districts** (consistent with the restoration of the deficit factor for non-basic-aid districts).

In addition to the augmentations listed above, the Budget proposes to spend over \$213 million from the **Proposition 98 Reversion Account** (into which Proposition 98 funds revert if not spent for their original purpose, and thus become available for an alternate purpose), as follows:

- \$106.6 million for **school facility emergency repairs** as required by the Williams settlement (SB 6, Ch 899, Statutes of 2004).
- \$63.7 million for CalWorks Stage 3 **child care**.
- \$18.7 million for education **mandates**.
- \$9.6 million to fully fund Beginning Teacher Support and Assessment (BTSA) **professional development** participation in the current year, 2005-06.
- \$9 million for **charter school facilities**.
- \$3 million for **teacher recruitment**.
- \$1.1 million for **principal training**.
- \$500,000 for athletic **coach training**.

Community College Funding Grows. The 2006-07 Budget provides over \$8.6 billion in total funds for community colleges. This represents a 7.6 percent funding increase, and the colleges' share of Proposition 98 (\$5.8 billion) rises to 10.79 percent. Student fees of \$26 per unit, the lowest in the nation and waivable for low-income students, will not rise. Major adjustments to the colleges' budget include:

- \$264.6 million for a 5.18 percent **COLA**.
- \$148.8 million for 3 percent **enrollment growth**.
- \$130 million for **equalization** of district revenue limits.
- \$30 million to expand and improve the relevance of **technical and vocational education** at high schools, regional occupational centers, and community colleges through "tech prep" or "2+2" programs. Total funding for this effort rises to \$50 million.

Higher Education

As the table below shows, the Governor's Budget proposes to increase total funding for higher education from \$9.8 billion to \$10.4 billion.

Higher Education Funding (Dollars in millions)				
	2005-06	2006-07	Difference	
UC	\$4,831.0	\$5,080.0	\$249.0	5.2%
CSU	3,848.2	4,029.3	\$181.1	4.7%
Student Aid Commission	838.9	897.0	\$58.1	6.9%
Other (Hastings, CPEC, etc)	<u>309.1</u>	<u>349.8</u>	<u>\$40.7</u>	13.2%
Total	\$9,827.2	\$10,356.1	\$528.9	5.4%

Compact with UC and CSU. The Governor's proposed funding for 2006-07 adheres to the terms of the compact he made with UC and CSU in 2004, with one notable exception, that of student fees. Specifically:

- Although his compact with the segments calls for annual student fee increases of 8% for undergraduates, 10% for graduate students, and 5% for professional students, the Governor is instead proposing to **freeze student fees**, at a cost of \$129.4 million (\$75.4 million for UC and \$54.4 million for CSU). Annual fees for resident undergraduates would thus remain at \$3,164 for CSU and \$6,802 for UC.
- Consistent with the compact, **institutional funding increases** are proposed at 3% for both UC and CSU (\$80.5 million and \$75.7 million, respectively), and **enrollment growth** is funded at 2.5% for both UC and CSU, at an aggregate cost of \$109.7 million, which includes \$19.7 million to increase the per-student rate ("marginal cost") funded through the state Budget.
- **The new UC Merced campus** is budgeted at \$24 million, including \$14 million in one-time funds.
- **Past-year legislative augmentations for outreach are deleted** from the budgets of UC (\$17.3 million) and CSU (\$7 million), leaving UC with \$12 million and CSU with \$45 million in non-state funds for outreach, as provided in the original compact.
- **No state funding for the UC Labor Institute** is included in the Governor's Budget.

In addition to those listed above, the Governor proposes further augmentations of:

- **\$1.5 million (\$1.1 million for CSU and \$375,000 for UC) to increase the number of future math and science teachers** educated by the two segments, and

- **\$3.4 million, split evenly between UC and CSU**, to address the state's nursing shortage through expansion of entry-level master's **nursing programs**.

Student Financial Aid Funding Grows. The Budget proposes to increase Cal Grants and other student aid funding administered by the Student Aid Commission to about \$897 million in 2006-07, a 6.9% increase over 2005-06. Proposed augmentations totaling \$58.2 million include:

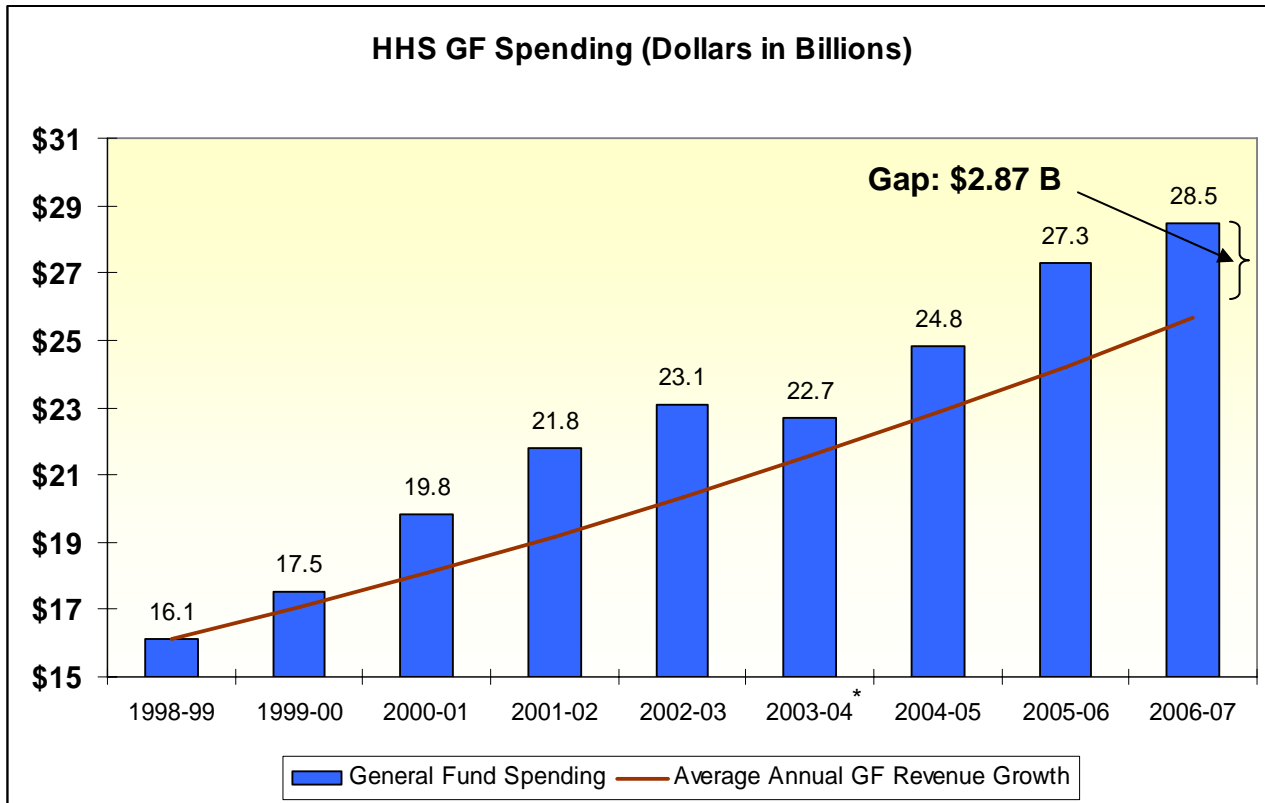
- **\$39.5 million for additional Cal Grants.** The number of Cal Grant awards is expected to top 250,000 in 2006-07.
- **\$11.9 million to increase the maximum Cal Grant award for students attending private institutions** from \$8,322 to \$9,708, and
- **\$6.8 million to expand the Assumption of Loans for Education (APLE) program**, including a set-aside of 600 awards for students participating in the math and science teacher initiative referenced above, and 100 new National Guard APLE awards.

Health and Human Services

The Governor's Budget proposes \$73.1 billion (\$28.5 billion General Fund) for all Health and Human Services Agency departments. This represents an increase of \$1.2 billion General Fund (4.4 percent) above the revised 2005-06 Budget amount. The Administration indicates that this increase is primarily related to inflation and caseload growth, but over \$117 million General Fund is proposed for new "critical" initiatives. The Budget also proposes to ***increase the number of new Health and Human Services state employees by 803.4 personnel years*** (an increase of about 2.6 percent) as California's public retirement pension programs continue to offer extravagant compensation packages that will cost the state nearly \$2.5 billion (\$1.4 billion General Fund) in 2006-07.

Compared to previous General Fund spending increases, such as the \$2.1 billion increase that was included in the 2005 Budget Act, the expenditure proposed for 2006-07 almost seems modest and the spending level is fairly consistent with the growth in state revenues. However, the fact that the spending increase is not accompanied by any meaningful spending reductions or programmatic reforms to reduce the rate of future expenditure growth in the health and human services programs is remarkable. This Budget largely maintains the status quo.

Chart 4



Note: This chart reflects actual GF expenditures versus growth based upon the average annual GF revenue growth rate. The gap is \$2.87 Billion in excess.

** The 2003-04 General Fund reflects one-time savings for accrual-to-cash accounting (\$1 billion) and enhanced federal fiscal relief (\$566.1 million) in the Medi-Cal program.*

Health

Department of Health Services

Limited Savings Proposals. The Governor's Budget does not include any meaningful program cuts or new cost containment proposals, but it does propose to garner a negligible \$32.1 million General Fund savings (about ***two-tenths of one percent*** of the Department of Health Services General Fund budget) from the following actions:

- **Reform Adult Day Health Care Program** - Reforms to combat fraud and maximize resources in this program by hiring nurses to inspect facilities and eliminating the use of a flat rate should result in savings of approximately \$19.3 million (\$9.8 million General Fund) in 2006-07.
- **Freeze County Administration Salary and Overhead Reimbursements** - This freeze of the state's contribution to county overhead and salaries at the 2005-06 level is anticipated to save \$42.4 million (\$21.2 million General Fund) in 2006-07.

- **Transfer Tobacco Settlement Fund to the General Fund** - The remaining unencumbered Tobacco Settlement Fund balance of \$1.1 million will be transferred to the General Fund.

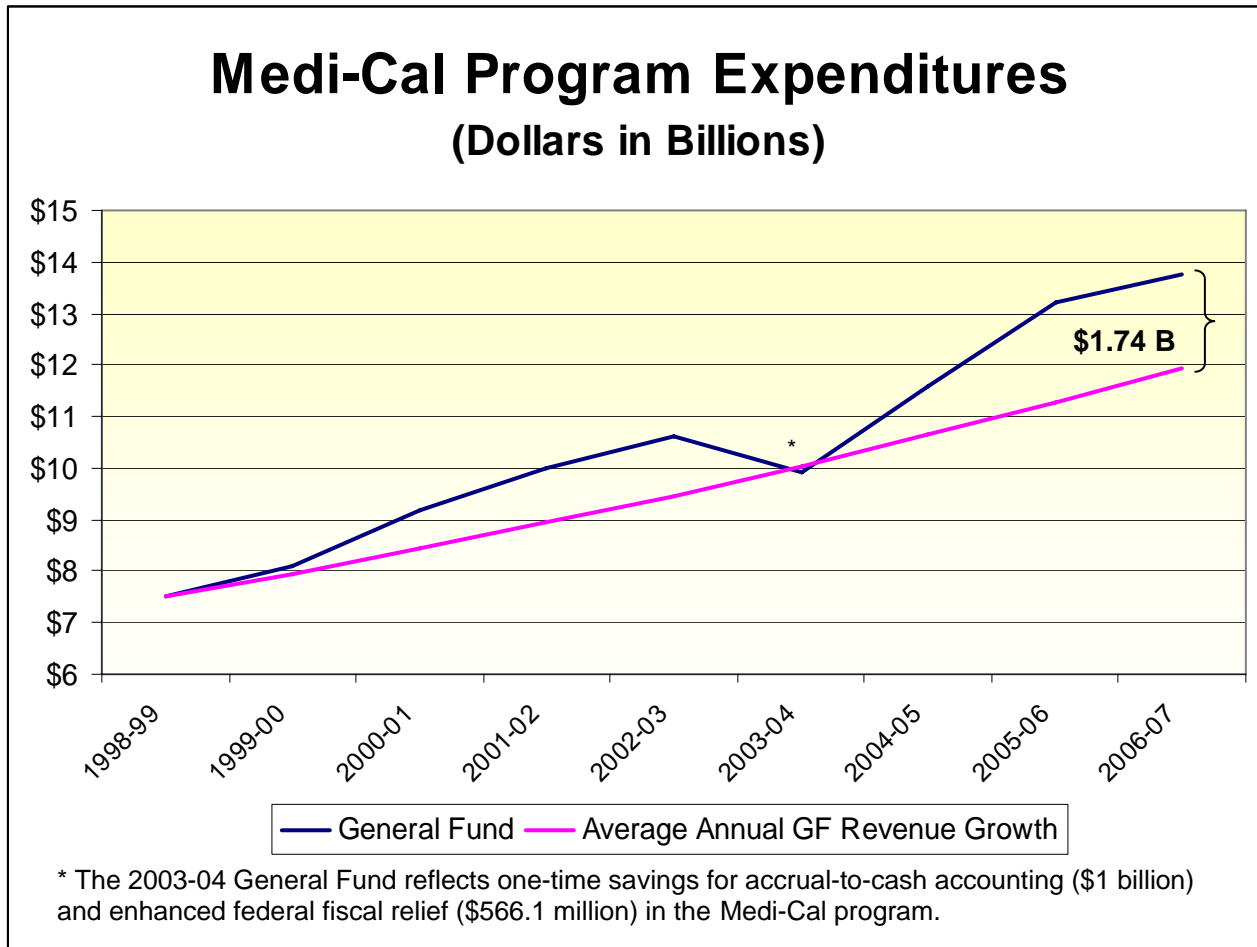
Medi-Cal. The Governor's Budget includes \$34.7 billion (\$13.7 billion General Fund), which reflects an increase of \$974.7 million (\$542.3 million General Fund) above the revised 2005-06 budget, which is an increase of 4.1 percent. Notably, this cost growth is well below the 2005 Budget Act growth rate (8.5 percent) and is generally in line with state revenue growth (4.9 percent). The General Fund increase primarily reflects increases in caseload and cost per eligible person; the elimination of one-time Medicare Part D savings; increased Medicare premiums; and growth in the number of aged, blind, and disabled persons eligible for Medi-Cal.

A recent PPIC study projects that Medi-Cal benefit expenditures will grow by about 8.5 percent annually over the next ten years. In 2010, the forecasts indicate that the total cost of the Medi-Cal program will rise to \$53.9 billion, \$19.7 billion of which would be paid by the state. By 2015, these totals will rise further to \$79.6 billion, with \$29.1 billion out of the General Fund (more than the combined cost of all Health and Human Services programs today). Overall population growth accounts for only about 17 percent of the projected increase in benefit expenditures.

At 8.5 percent, the average growth in Medi-Cal expenditures will outpace the expected 6 percent annual growth in state revenues projected by the Legislative Analyst's Office. Accordingly, Medi-Cal can be expected to absorb a growing share of the overall General Fund budget, rising from 15 percent in 2003 to 19 percent in 2010 and 21 percent in 2015. ***In 2010, forecasts indicate that Medi-Cal will require an additional \$3.7 billion over and above the costs expected if Medi-Cal expenditures remained a constant share of state revenues.***

California provides more optional Medi-Cal services than any other large state (in fact California provides virtually every optional service), and covers a higher percentage of residents than any other state except New York. Given the tremendous cost growth and the forecasts for the future it seems clear that substantive cost containment strategies must be a part of California's budget plans for Medi-Cal, but the Administration has not included any such proposals as part of the Budget.

Chart 5



Note: This chart reflects actual GF expenditures versus growth based upon average GF revenue growth rate. The gap is \$1.74 Billion in excess.

Major Medi-Cal Budget Proposals:

Increasing Enrollment in Medi-Cal. As part of a larger Governor's initiative to increase enrollment of children and retain those already enrolled in state health programs the Governor's Budget includes \$69.7 million (\$33.2 million General Fund) to fund proposals that encourage the enrollment of "children" into Medi-Cal and provide for the related caseload increase. However, the estimated 24,213 Medi-Cal beneficiary caseload increase associated with "Form Simplification" ***includes adults as well as children***:

- **Provide Counties with Funding for Outreach Activities.** \$20.8 million (\$9.1 million General Fund) for service contracts to perform outreach and enrollment activities.
- **Medi-Cal Redetermination Form Simplification.** \$45.5 million (\$22.7 million General Fund) for caseload growth as a result of simplifying the Medi-Cal redetermination form to decrease turnover within the program.
- **Media Campaign.** \$3.4 million (\$1.4 million General Fund) for a media campaign to encourage the enrollment of all eligible children into a state health care program.

Medi-Cal Provider Rate Decrease. The Budget assumes savings of \$90.3 million (\$42.6 million General Fund) from implementation of a 5-percent provider payment reduction consistent with AB 1735 (2005). This rate reduction is effective January 1, 2006 and sunsets December 31, 2006. Certain providers are exempt from the reduction (e.g., pharmacies, clinical labs, durable medical equipment, adult day health care, hospice, and FQHC/RHC clinics). ***Current year (2005-06) savings of \$53.3 million (\$25 million General Fund) are allocated to offset an anticipated Medi-Cal deficiency, which is in excess of \$200 million General Fund.***

Mandatory Enrollment of Seniors and Persons with Disabilities. The Governor's Budget includes \$2 million (\$936,000 General Fund) for DHS to phase in expanded enrollment of seniors and persons with disabilities by developing and implementing statewide managed care performance standards, designing specific education and outreach efforts aimed at increasing voluntary enrollment in managed care counties, and initiating mandatory enrollment of seniors and persons with disabilities not eligible for Medicare in two (unspecified) counties.

Increase Reimbursement Rates for Long-Term Care Facilities. The Governor's Budget includes \$172 million (\$86 million General Fund) for a 5.4-percent rate increase to freestanding level B nursing homes and adult sub-acute facilities that provide long-term care to Medi-Cal beneficiaries.

Licensing and Certification Modifications. As part of the "Licensing Reforms" initiative the Governor's Budget includes \$64.1 million (\$652,000 General Fund), which reflects a net increase of \$18.9 million (a decrease of \$45.9 million General Fund) above the 2005 Budget Act. The Governor's Budget proposes the creation of a special fund for all Licensing and Certification Program activities so that fees and expenditures related to the program can be better tracked, and it appears that these *fees will be increased* to fund the costs of this initiative. The Budget proposes ***147.7 new state employee personnel years*** as part of this effort to "improve access to necessary services, and meet current statutory requirements".

Public Health. The Budget proposes total expenditures for all public health programs and state administration of \$3.7 billion (\$645.9 million General Fund) in 2006-07. This represents an increase of \$120.5 million, or 3.4 percent above General Fund expenditures in the revised 2005-06 budget.

Major Public Health Budget Proposals:

Emergency Preparedness and Response. The Budget includes an increase of \$45.8 million General Fund and 55.1 new state employees to expand emergency preparedness, mitigation, and response activities. The need for these additional resources is unclear since the state has received over \$280 million of federal funds and 105 new state positions since 1999-00. ***It seems that much of the infrastructure and state staff requested by the Governor's proposals is duplicative of the activities covered by the federal grants.*** Specifically, the Governor requests:

- \$17.9 million General Fund for local health departments to support local activities related to the prevention of a pandemic influenza outbreak.

- \$14.3 million General Fund to develop and publicize a statewide pandemic influenza public education and information campaign and develop a general emergency preparedness communications campaign.
- \$4.2 million General Fund to strengthen the state laboratory infrastructure and staffing resources to conduct more efficient testing, increase laboratory surge capacity, conduct influenza-specific testing, and establish training programs to provide a pool of candidates to backfill local public health laboratory directors as they retire.
- \$4.2 million General Fund to expand state efforts and assist local agencies in how to plan, respond, train, and recover from disasters and terrorist incidents.
- \$1.5 million General Fund to purchase Tamiflu and manage the antiviral, vaccines, and medical supplies that California will need during a pandemic.
- \$1.4 million General Fund to develop and maintain an ongoing program for prevention and control of healthcare and community infections through provider education, surveillance, and laboratory testing.
- \$1.3 million General Fund to expand and maintain state and local capacity to conduct communicable disease surveillance.
- \$1 million General Fund to strengthen DHS' pandemic influenza planning effort, conduct epidemiologic investigations of influenza and respiratory disease outbreaks, and provide epidemiologic and statistical support to the infectious disease laboratories.

Prostate Cancer. The Governor's Budget includes \$3.5 million General Fund on a one-time basis to continue the Prostate Cancer Treatment Program in 2006-07 pursuant to the provisions of Chapter 442, Statutes of 2005 (SB 650). The Improving Access, Counseling, and Treatment for Californians with Prostate Cancer (IMPACT) Program provides free prostate cancer treatment services to low-income, uninsured men. This level of funding will provide a full year of direct patient care, while the results of the pending evaluation are reviewed for funding consideration in 2007-08. It is estimated that this program will provide treatment to nearly 376 patients in 2006-07.

HIV/AIDS Treatment and Prevention. The Budget proposes \$409.4 million (\$174.9 million General Fund) for the Office of AIDS' Treatment and Prevention Program. This is a total increase of \$24 million (6.2 percent) above the revised 2005-06 budget, which exceeds the state revenue growth rate of 4.4 percent. No fiscal reforms are proposed for these programs that are clearly growing at an unsustainable pace.

Managed Risk Medical Insurance Board

Healthy Families Program. The Governor's Budget provides \$1.1 billion (\$377 million General Fund), which is an increase of \$50 million General Fund (15.3 percent) above the revised expenditures of \$908.4 million (\$327 million General Fund) in 2005-06. This rate of expenditure growth far exceeds the state revenue growth rate of 4.4 percent, which raises issues about the ability to sustain further program growth without new revenues (i.e., new taxes). According to the Administration, this increase is primarily the result of enrollment that

is projected to grow from 827,300 by year-end 2005-06 to 933,100 in 2006-07 for a total increase of 105,800 children, or 12.8 percent.

Increasing Enrollment in the Healthy Families Program (HFP). As part of a larger effort to increase enrollment in state health programs such as Healthy Families and Medi-Cal the Administration proposes \$12.1 million (\$4.5 million General Fund) to fund new activities that encourage the enrollment of eligible children into HFP. However, the proposed Budget does not reflect any additional funding for caseload growth as a result of these new efforts; therefore, it appears that the Administration either made an error in developing the caseload estimate or it does not believe that these new efforts will have any impact. It is estimated that there are 428,000 children currently eligible for Medi-Cal or HFP, but are not enrolled. Specifically, the Governor's Budget proposes the following:

- **Streamline Enrollment Processes for Children's Health Programs.** \$9.6 million (\$3.5 million General Fund) to simplify the enrollment process of children into the HFP. This program change is supposed to encourage the use of the electronic application (known as "Health-e-App"), enhance enrollment, retain current eligible children, and ease administrative duties.
- **Increase the Number of Applicants for Children's Health Programs.** \$2.5 million (\$1 million General Fund) to provide incentive payments to Certified Application Assistants to encourage enrolling more children in Medi-Cal and HFP. This is in addition to \$11.8 million (\$4.8 million General Fund) included in 2006-07 base funding that builds on the 2005 Budget Act re-establishment of the Certified Application Assistance (CAA) program. The CAA program provides payment of \$50 for a new application and \$25 for an annual eligibility review to individuals and organizations that help potential eligibles fill out the application forms. Both advocates and the Managed Risk Medical Insurance Board have cited the lack of outreach and application assistance funding as the primary reason enrollment in HFP leveled off in the past. However, there are no studies that support the efficacy these outreach efforts.

Department of Mental Health

Civil Rights for Institutionalized Persons Act (CRIPA). The Governor's Budget includes \$43.5 million (\$37.8 million General Fund) and **432 new state employees** for CRIPA compliance. According to the Administration, these efforts will reflect a change in treatment philosophy to focus on recovery rather than on the disease, disability, or disorder. Under the proposed recovery-oriented treatment system, state hospitals will focus on the functional skills desired and necessary to live successfully after discharge, provide treatment, rehabilitation, and supports to develop these skills, as well as address the patient's psychiatric and psychological problems. Additional funds will likely be requested in the Governor's May Revision for an electronic system for collecting and reporting patient treatment information throughout state hospitals.

AB 3632 Mandate. The Budget continues to provide \$100 million (\$69 million in federal funds, and \$31 million Proposition 98 General Fund) in special education funding in the Department of Education budget for mental health services to special education pupils. In addition, the Budget includes \$50 million non-Proposition 98 General Fund as a set-aside in the Commission on State Mandates budget for funding mental health services to pupils under the

new categorical program. The Administration indicates that it may include a refined AB 3632 proposal in the May Revision.

Department of Developmental Services

Regional Centers. The Governor's Budget proposes \$3.1 billion (\$2 billion General Fund) to support the regional centers, a net increase of \$227.5 million (\$171.4 million General Fund) from the revised 2005-06 Budget. ***This increase of 9.4 percent exceeds the state revenue growth rate of 4.4 percent and raises concerns about the fiscal sustainability of these programs absent an increase in state revenue.*** The regional center community population is projected to increase by 8,575 consumers to 213,740 consumers in 2006-07, which includes 177 Agnews residents who will be moved into the community.

Minimum Wage Increase Costs. As a result of the Administration's proposal to increase the minimum wage from \$6.75 to \$7.25 per hour, the Budget proposes \$8.3 million (\$5.5 million General Fund) to fund non-state employee wages for services provided via grants and contracts with the Department of Developmental Services.

Long-Term Cost Containment. The Governor's Budget includes \$7.6 million General Fund for regional centers to implement new contract requirements that are intended to reduce costs in the future. The resulting General Fund cost reductions to regional center purchase of services are estimated to be \$10.6 million in 2006-07, \$21.1 million in 2007-08, and \$31.7 million in 2008-09 and each year thereafter. Beginning in January 2006, DDS will initiate contract negotiations with regional centers to provide the regional centers with additional responsibilities and tools to control the growth in expenditures.

Regional Center Provider Rate Increase. The Budget proposes \$67.8 million (\$46.1 million General Fund) to provide a 3-percent cost-of-living increase to program providers that have had their rates frozen during the past three years.

Autistic Spectrum Disorder Initiative. The Budget includes \$2.6 million General Fund for expansion of the Autistic Spectrum Disorder (ASD) Initiative. This includes \$1.9 million for regional centers to provide a new ASD program coordinator and clinical specialist in each regional center. The remaining \$680,000 is provided for training clinicians and other professionals to implement existing best practice guidelines.

Human Services

Department of Social Services. The Governor's Budget does not include significant program reforms that would address the state's structural deficit in the out years. While the Governor's Budget continues the suspension of the CalWORKs grant cost-of-living adjustments (COLAs), the state remains the highest grant level in the nation, and costs for the COLA will significantly impair the balance of the 2007-08 Budget. Additionally, the Budget extends the July 2007 Supplemental Security Income/State Supplementary Payment (SSI/SSP) COLA suspension for an additional 15 months, but expenditures for the COLA will be significant in 2008-09 and will put pressure on the General Fund at that time. Coinciding with these funding pressures, expenditures for the In-Home Supportive Services program continue to increase, with no

proposed reform in sight. These structural problems will need to be considered during the next few months as the final budget takes shape.

Welfare-to-Work. The Budget provides \$6.7 billion for California Work Opportunity and Responsibility to Kids (CalWORKs) programs, including \$4.9 billion for programs within the Department of Social Services (DSS), \$1.6 billion for other programs, and \$181.4 million for a reserve to mitigate the potential for additional federal requirements and penalties. The funding consists of \$3.7 billion in federal funds from the federal Temporary Assistance to Needy Families (TANF) grant, \$2.5 billion state General Fund, \$284.7 million federal TANF funds available from previous years, \$149.3 million from other county sources, and \$33.0 million in Employment Training Panel funds. The following chart depicts 2006-07 CalWORKs expenditures by program area, within the Department of Social Services and includes other state departments.

Table 5

2006-07 CalWORKs Expenditures (Dollars in millions)	
CalWORKs Components	Expenditures
DSS:	
Assistance Payments	\$ 3,023
Employment Services	977
County Administration	232
DSS Child Care	487
Kin-GAP	84
Tribal TANF	56
DSS Admin	<u>26</u>
Subtotal	\$4,884
Other CalWORKs Programs:	
Statewide Automated Welfare System	\$73
Child Welfare Services	274
California Food Assistance Program	6
State Supplementary Payment Program	9
Foster Care	54
State Department of Education Child Care	934
California Community Colleges Child Care	15
CCC Education Services	20
DCSS Disregard Payments	33
Department of Developmental Service	56
County Costs	<u>149</u>
Subtotal	\$1,623
TANF Reserve	\$181
Total CalWORKs Expenditures	\$6,688

The Budget indicates that caseload growth is increasing slightly after many consecutive years of decline. Estimated CalWORKs caseload for 2006-07 is 487,000 cases, a 0.7-percent increase over the 2005-06 projection.

Chapter 78, Statutes of 2005 suspended both the July 1, 2005 and July 1, 2006 CalWORKs grant cost-of-living adjustment (COLAs), resulting in cost avoidance of \$121.8 million in 2005-06 and \$307.2 million in 2006-07.

The Governor's Budget continues to maintain a policy of utilizing only the available federal block grant funds and the federally required level of state funds for the CalWORKs program. As a result, *\$198.9 million* in net program reductions are required to maintain expenditures within this level:

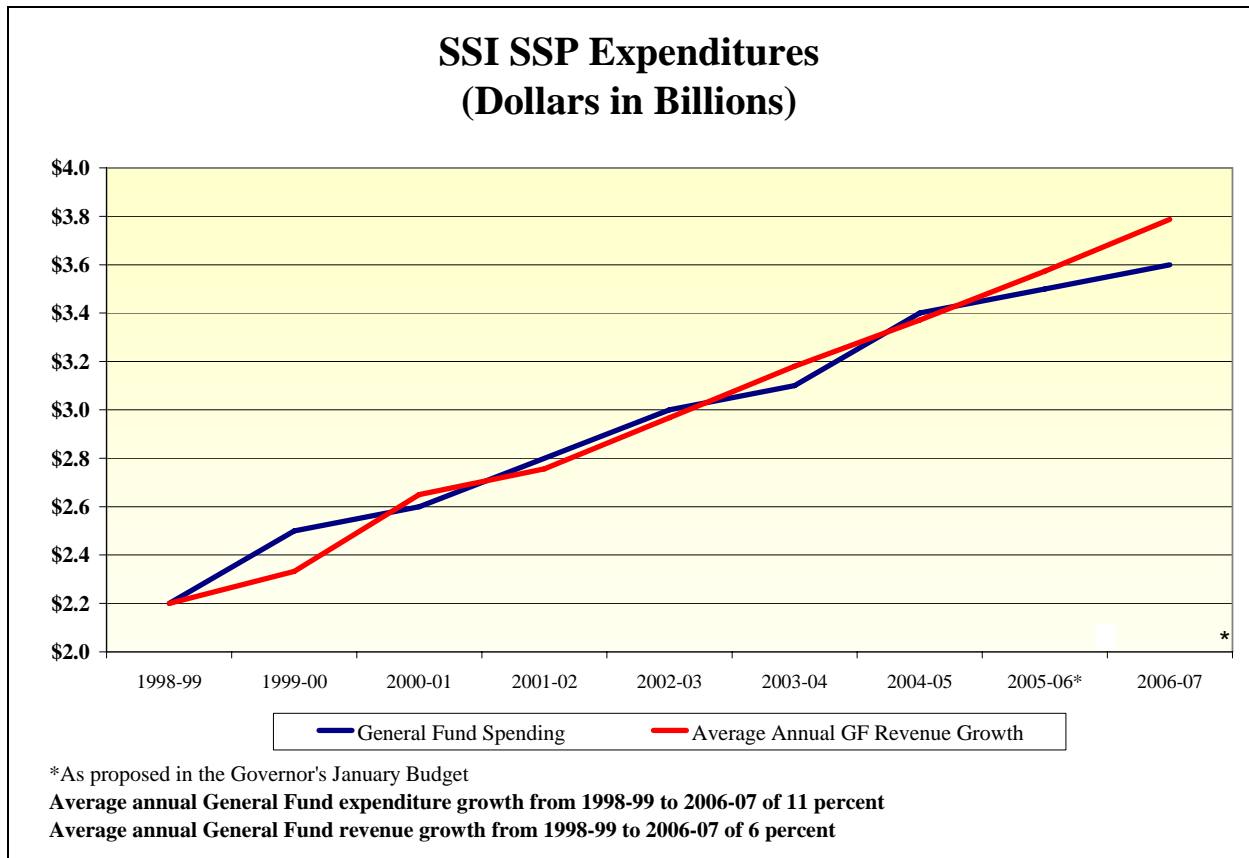
- **Updated Welfare Reform Implementation.** The 2005 Budget Act assumed full implementation of welfare reforms initiated in 2004-05 that were expected to increase the work participation levels within the CalWORKs program. This increase in work participation was expected to result in grant savings, partially offset by additional employment services and child care costs. The reforms, however, have not been implemented and \$16.3 million in savings has been lost in the current year. Based on the revised implementation schedule, the Budget includes savings of *\$27.9 million* in 2006-07 for welfare reform.
- **Recover Child Care Expenditures Associated with Welfare Reform.** Based on the lower number of recipients working than was projected with implementation of welfare reform, the funding for child care included in the 2005 Budget Act associated with increased work participation is not expected to be utilized at the county level. The Governor's Budget proposes to pull back *\$114.6 million* from counties' 2005-06 single allocation funding and carry the money forward into 2006-07. The Governor's Budget does set aside \$11.5 million in the 2005-06 TANF reserve, for counties to utilize if they incur additional child care costs.
- **Pay for Performance Delayed Implementation.** The Budget Act of 2005 assumed \$22.2 million in grant savings from implementation of a new incentive program that rewards counties for improvements in identified CalWORKs program outcomes. Projected savings have now been reduced to \$2.8 million in the current year and the Governor's Budget includes \$6.3 million to reflect ongoing implementation efforts. Incentive funds totaling *\$30 million* were set aside in the TANF reserve for allocation to counties in 2006-07. The Governor's Budget proposes to delay incentive payments while DSS works with counties to fully implement the "work-first" approach and core work requirements included as part of welfare reform.
- **Maintain State Department of Education (SDE) Child Care Expenditures Counted Toward TANF Maintenance of Effort (MOE) at Current Levels.** Historically, the Administration has counted all eligible SDE General Fund child care expenditures toward the TANF MOE requirement, which results in corresponding General Fund savings in the DSS budget. However, although revised estimates of SDE child care expenditures indicate that an additional *\$80 million* could be counted toward the MOE for 2005-06 and 2006-07 combined, the Governor's budget proposes to maintain the SDE MOE-eligible child care expenditures at the 2005 Budget Act level in 2005-06 and 2006-07, resulting in avoidance of additional reductions.

County Single Allocation Reduced by \$40 million. The Governor's budget includes a proposal to reduce the 2006-07 CalWORKs single allocation to counties by *\$40 million* and utilize these federal TANF funds to offset General Fund costs in Child Welfare Services by \$39.1 million and Foster Care by \$900,000. The single allocation supports CalWORKs employment services, child care services, and county administration expenditures. Counties would be able to backfill this reduction with county performance incentive funds previously earned and allocated to counties but not spent.

Additional Augmentations. The reductions identified above, however, are partially offset by additional CalWORKs expenditures (actually lost savings) for quarterly reporting/prospective budgeting. Chapter 1022, Statutes of 2002 required the replacement of a monthly reporting/retrospective budgeting system with a quarterly reporting/prospective budgeting system within the CalWORKs program. The prospective budgeting system was projected to result in significant administrative savings at the county level (\$126.1 million projected for 2005-06). The TANF reserve includes \$25 million in 2005-06 (would reduce savings from \$126.1 million to \$101.1 million) in the event that savings projections for the prospective budgeting system are inaccurate. The Administration is reviewing time study and county survey data that the state can use to validate the current level of estimated savings for the program. In the meantime, the Governor's Budget sets aside an *additional \$25 million* in 2005-06 (would reduce projected savings even further, from \$101.1 million to \$76.1 million) for this purpose, and includes a placeholder of \$25 million in 2006-07 (savings would be reduced from \$127.7 million to \$102.7 million) to account for any additional expenditures.

Supplemental Security Income/State Supplementary Payment (SSI/SSP)

Chart 6



The Budget proposes \$3.6 billion for SSI/SSP in 2006-07, a 1.7-percent increase from the revised 2005-06 Budget (see Chart 6 above). The Budget estimates 1.2 million cases in 2006-07, an increase of 2.4 percent over 2005-06. The caseload consists of 68 percent disabled, 30 percent aged, and 2 percent blind persons.

- **Continued Suspension of January 2007 Cost of Living Increase.** The Governor's Budget proposes to extend withholding the pass-through of the January 2007 federal COLA until July 2008. This proposal would result in General Fund savings of \$48.1 million in 2006-07 and over \$185 million in 2007-08. Chapter 78, Statutes of 2005, suspended the pass-through provision of the January 2006 and January 2007 federal SSI COLAs until April 2006 and April 2007, respectively. Beginning in April 2006, monthly grant payment levels will be increased to \$836 for an aged or disabled individual and \$1,472 for a couple. As shown in the table below, even with this proposal, California continues to provide the highest level of cash grants to SSI/SSP recipients among the ten most populous states.
- **Cash Assistance Program for Immigrants (CAPI).** The Administration proposes to continue the current statutory sponsor deeming period for the CAPI another five years. During the deeming period, the income and resources of the person sponsoring the non-citizen will be taken into account when determining benefit eligibility. The extension

would result in cost avoidance of \$12.5 million General Fund in 2006-07, and could grow to over \$40 million in General Fund cost avoidance in 2007-08.

Table 6

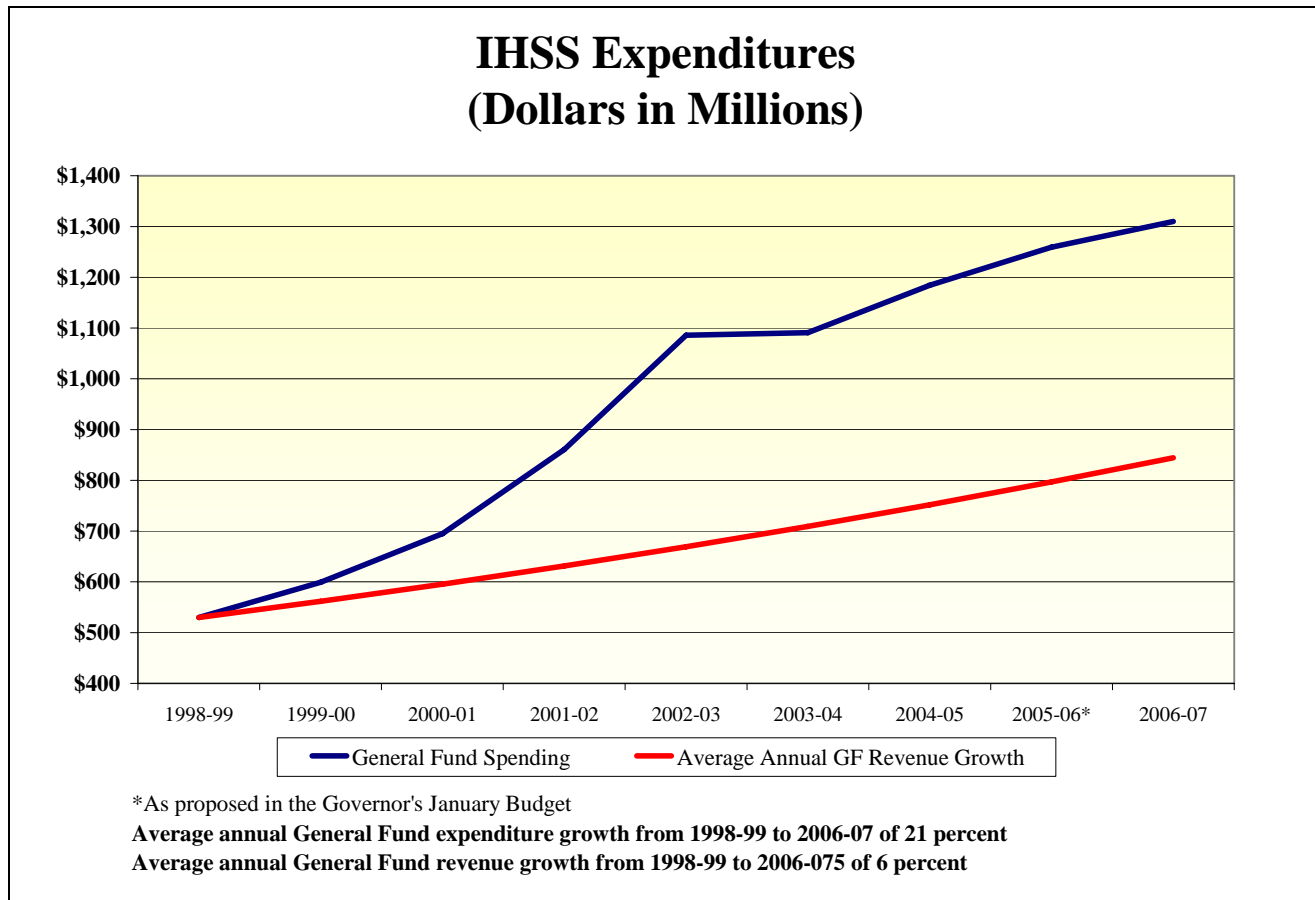
Comparison of the 2005-06 SSI/SSP Maximum Payments for the Ten Most Populous States				
	Aged and Disabled		Blind	
State	Individual	Couples	Individuals	Couples
California	\$836	\$1,472	\$901	\$1,699
New York	690	1,008	690	1008
New Jersey	634	929	634	929
Pennsylvania	630	948	630	948
Michigan	617	932	617	932
Florida	603	904	603	904
Georgia	603	904	603	904
Texas	603	904	603	904
Illinois	603	904	603	904
Ohio	603	904	603	904

In-Home Supportive Services (IHSS)

As shown in Chart 7 below, the Budget proposes \$1.3 billion General Fund for the IHSS program in 2006-07, an increase of 4.1 percent from the revised 2005-06 Budget. The caseload is estimated to be 396,000 recipients in 2006-07, a 6.4-percent increase over the 2005-06 projected level.

Last year the Administration proposed limiting the state's participation in IHSS worker wages. General Fund expenditures for the IHSS program had grown 120 percent from 1998-99 to the 2004 Budget Act, even though the caseload grew by only 65.3 percent. The reason for the disproportionate cost growth was an increase in the costs per case. This disproportionate growth is still evident today and the Governor's 2006-07 Budget does not offer any programmatic reforms to curb General Fund expenditures in the IHSS program and help alleviate some of the state's structural deficit in the near future.

Chart 7



Child Welfare Services

The Budget provides \$3.8 billion (\$1.4 billion General Fund) for services and out-of-home care for children who are either at risk of or have suffered abuse and neglect. This is an increase of \$89.1 million (\$29.5 million General Fund), or 2.4 percent, from the revised 2005-06 budget.

The Governor's Budget includes \$32.9 million (\$19.1 million General Fund) in 2006-07 for a series of Children's Services initiatives designed to ensure the safety of children and improve outcomes. Program success is measured in terms of improving the safety, permanence, and well-being of the children and families served. These programs include:

- **Permanency Options for Older Youth.** This proposal would provide \$12.5 million (\$7.1 million General Fund) to improve permanency outcomes for children through adoption and an increase in foster care exits.
- **Implementation of Child Welfare Legislation.** This proposal would provide \$15.2 million (\$8.1 million General Fund) to implement recently chaptered child welfare legislation which expands county workload and establishes a new category of licensed placement which provides a higher foster care rate for dependent teen parents and their children in foster care.

- **Kinship Support Services.** This proposal would provide \$2.5 million General Fund to augment the Kinship Support Services Program which provides services to caregivers who provide for their relative children. The funding would be allocated on a competitive basis to counties that are able to demonstrate the cost-effectiveness of this program and generate out-year savings.
- **Transitional Housing for Foster Youth.** This proposal would provide an additional \$2.6 million (\$1.4 million General Fund) to the Transitional Housing for Foster Youth program, which provides transitional housing placement services to youth that have emancipated from the foster care system. This augmentation doubles the budget of this program to \$5.2 million (\$2.8 million General Fund). Historically, counties have not spent all the money allocated for this program and it is unclear whether the additional General Fund commitment is warranted.

Community Care Licensing

The Governor's Budget includes \$91.5 million (\$19.4 million General Fund) for licensing activities, a \$7.6 million General Fund or 64.5-percent increase from the revised 2005-06 budget.

The Governor's Budget includes \$6.7 million (\$6 million General Fund) for a comprehensive licensing reform initiative that includes the following major components:

- \$5.2 million (\$4.8 million General Fund) to increase the number of random sample licensing visits from 10 percent to 20 percent annually. This would enable the state to comply with the statutory requirement that all community care facilities be visited at least once every five years.
- \$956,000 (\$654,000 General Fund) to implement a series of administrative proposals that would improve the operational efficiency of the licensing program.
- \$596,000 (\$561,000 General Fund) to establish a Licensing Program Analyst Training Academy.

The Governor's Budget also proposes to continue the suspension of the Fee-Exempt Live Scan Program for two additional years. This program pays the one-time \$40 FBI fingerprinting fee for small licensed family child care homes. The program has been suspended for the past three years due to budget constraints, and the suspension would result in General Fund savings of \$1.2 million in each year.

Department of Child Support Services

The Budget proposes \$1.4 billion (\$517.3 million General Fund) for child support services. This is an increase of \$9 million (\$4 million General Fund) above the revised 2005-06 Budget.

- **Automated System Penalties.** The Budget includes \$220 million General Fund in 2006-07 for payment of the federal fiscal year (FFY) 2006 penalty. Federal penalties have been levied against the state for the past several years as a result of the delayed implementation of a single, statewide automated child support system. The Governor's Budget assumes there will not be a penalty for FFY 2007 as a request for federal certification is expected to be submitted to the federal government by September 2006.

Department of Alcohol and Drug Programs

The Budget proposes \$537.5 million (\$243.2 million General Fund) for alcohol and drug programs. This is a slight increase over the revised 2005-06 Budget but is a significant General Fund increase if one considers that the funding for drug treatment under Proposition 36 sunsets June 30, 2006.

Proposition 36, the Substance Abuse and Crime Prevention Act of 2000 (SACPA), was approved on November 7, 2000. The SACPA is intended to reduce drug abuse through treatment rather than prison time. The SACPA provided an annual \$120 million General Fund transfer to the Substance Abuse Treatment Trust Fund from 2001-02 through 2005-06 to support state-level and local SACPA-related activities. Again, this funding stream is due to sunset June 30, 2006.

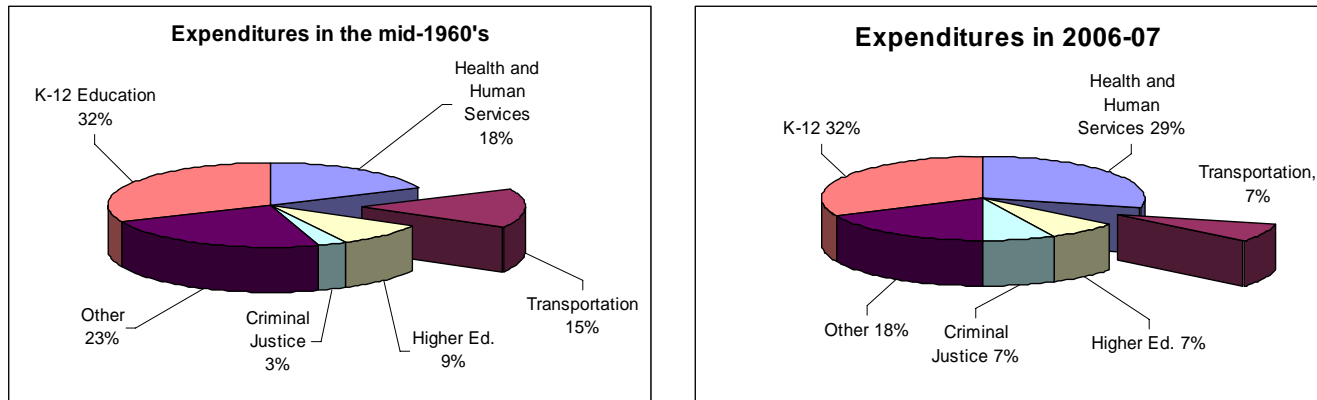
The Governor's Budget proposes to maintain the General Fund transfer of \$120 million on a one-time basis for 2006-07, conditioned upon the Legislature passing reforms to the program. While evaluations may or may not show participants have lower revocation rates, only 34 percent of those entering treatment complete their programs. A thorough evaluation of this program is needed, and should be done with consistent and reliable outcome data before the state commits a significant amount of General Fund.

Transportation

Over the past several decades, the proportion of state funds (special funds plus General Fund) dedicated to transportation has been shrinking, when measured as a percentage of total state expenditures. In the mid 1960's, expenditures for transportation infrastructure and enforcement programs, including the Department of Motor Vehicles (DMV), and the California Highway Patrol (CHP), accounted for approximately 15.2 percent of total state spending. By 2000, this number had dropped to ***only 5.2 percent***, giving way to dramatic increases in other program areas, primarily health and human services.

For fiscal year 2006-07, the Governor's Budget proposes expenditures of approximately \$8.7 billion in state funds for transportation infrastructure and enforcement programs. This represents approximately 7.1 percent of total state expenditures. The charts below show the decline of state funds for transportation infrastructure and enforcement as a proportion of the total state budget, from the mid-1960's to 2006-07.

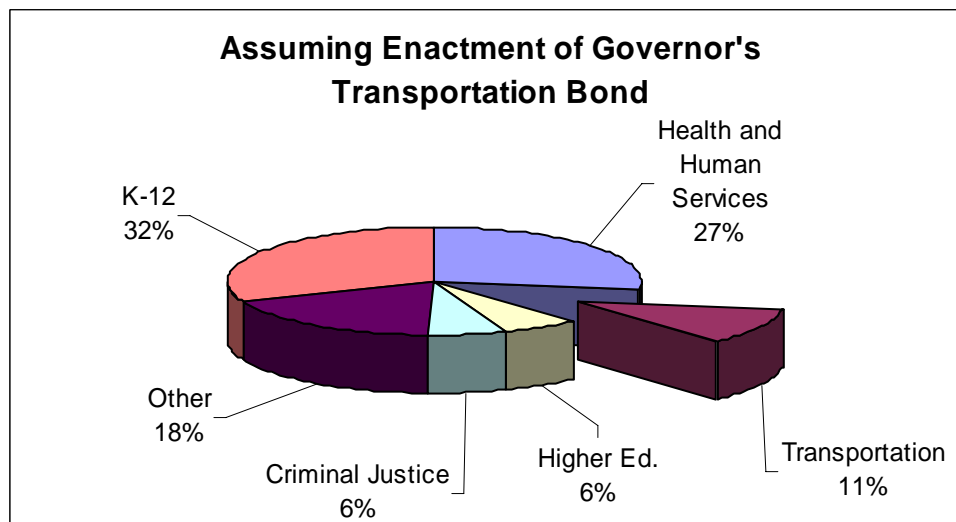
Chart 8



Note: When expenditures for the DMV and CHP were excluded, transportation infrastructure spending accounted for approximately 12.6 percent in the mid-1960's and 5.9 percent in 2006-07.

The Governor's general obligation infrastructure bond proposal, known as the Strategic Growth Plan, cites a three-fold increase in the number of registered vehicles between the 1960's and 2005, and a five-fold increase in the number of vehicle miles traveled. Yet, of the total \$68 billion proposed in the bond, **only 17 percent** (\$12 billion over a 2-year period) would be used for transportation purposes. Assuming the bond is enacted and transportation resources increased by \$6 billion in 2006-07, funding for transportation infrastructure and enforcement programs would account for **only 11 percent of total state spending**, as shown in the figure below. (For more information on the bond proposal, see discussion under "Governor's Infrastructure Bond Proposal for Transportation").

Chart 9



Note: This estimate assumes that expenditures in other program areas (i.e., health and human services) remain the same. If expenditures in these other programs are increased either through budget augmentations or bond appropriations, the percentage of total state spending for transportation would be even less.

Proposition 42. Enacted by the voters in the March 2002 election, Proposition 42 amended the state Constitution to permanently dedicate sales taxes on gasoline for transportation projects. Specifically, the Proposition requires the transfer of gasoline sales tax revenues from the General Fund to a newly created Transportation Investment Fund (TIF). The Proposition also allows the Administration and the Legislature (if two-thirds of the membership approve) to suspend the transfer of sales tax revenues in a fiscal year in which the transfer will result in a significant negative impact on government functions funded by the General Fund.

The transfers were suspended in the first two years that Proposition 42 became effective. In fiscal year 2003-04, \$868 million of the \$1.157 billion in gasoline sales tax revenues was suspended. For 2004-05, the entire \$1.243 billion was suspended, for a combined total of \$2.1 billion. However, Proposition 42 is fully funded in 2005-06 at \$1.3 billion.

For 2006-07, the Governor's budget proposes to transfer the full \$1.406 billion, and allocate the funds pursuant to existing law as follows:

- \$678 million to the Traffic Congestion Relief Fund
- \$582 million to the State Transportation Improvement Program
- \$146 million to the Public Transportation Account

Table 7 below displays the funding and suspension history of Proposition 42 since implementation in 2003-04.

Table 7

Proposition 42 Funds		
(Dollars in millions)		
<u>Fiscal year</u>	<u>Amount to be Transferred</u>	<u>Amount Suspended</u>
2003-04	\$1,157	\$868
2004-05	1,243	1,243
2005-06	1,313	0
2006-07	1,406	0
Total	\$5,119	\$2,111
41% of Proposition 42 Funds Have Been Suspended		

In addition to the \$1.4 billion transfer, the Governor's budget proposes to repay \$920 million of prior Proposition 42 loans in 2006-07, and \$430 million in 2007-08. This leaves an outstanding balance of approximately \$900 million (including interest) in the out-years. In total, the budget provides \$2.3 billion of Proposition 42 funds in 2006-07 for transportation programs.

Also, as part of the infrastructure bond package, the Administration proposes a constitutional amendment to prohibit suspensions of Proposition 42 transfers after 2006-07. (See discussion under "Governor's Infrastructure Bond Proposal for Transportation" below).

Governor’s Infrastructure Bond Proposal for Transportation. The Governor’s Strategic Growth Plan includes two general obligation bonds of \$6 billion each for transportation projects in 2006 and 2008. The total \$12 billion would be allocated for the following general purposes:

Table 8

Description	Amount (dollars in millions)
Highway capacity and congestion relief	\$5,300
Highway safety, maintenance and preservation	1,500
Goods movement infrastructure and improvements	3,000
Ports and air quality mitigation projects	1,000
Intercity rail	500
Corridor mobility improvements	300
Intelligent transportation systems	200
Park & ride opportunities, and bicycle improvements	200
Total	\$12,000

The bond vehicles will be AB 1838 and SB 1165. Also, as part of the infrastructure bond package, the Administration proposes the following:

- A constitutional amendment to prohibit suspensions of Proposition 42 transfers after 2006-07. Republicans have argued that taxes imposed on gasoline sales ought to be dedicated to transportation projects to alleviate traffic congestion and repair streets and roads. This proposal would help ensure that voter-approved transportation funds are used only for transportation purposes. These provisions are proposed in ACA 4.
- A series of legislation known collectively as “GoCalifornia” to improve transportation management and project delivery by:
 - Increasing opportunities for public-private partnerships in the construction of High Occupancy Toll (HOT) lanes, whereby a single passenger may access a diamond lane if they pay a specified toll. These provisions are proposed in AB 850.
 - Increasing the use of design-sequencing on transportation projects, allowing construction to begin prior to full completion of the design phase. These provisions are proposed in AB 1266.
 - Increasing the use of design-build so that one contractor would be responsible for both the design and construction of the project. These provisions are proposed in SB 371.

Repayment of Transportation Loans from Tribal Gaming Bonds Delayed. Between fiscal years 2001-02 and 2004-05, the General Fund borrowed a total of \$3.667 billion from transportation, including \$1.556 billion in loans from various transportation accounts, and \$2.111 billion from the 2003-04 and 2004-05 Proposition 42 suspensions.

For 2004-05, a total of \$1.397 billion was proposed to be repaid from a variety of funding sources, authorized by both the 2004 Budget Act and AB 687 related to tribal gaming compacts. Specifically, the Budget Act authorizes repayment of \$183 million from a combination of General Fund and Public Transportation Account “spill-over” revenues. Also, AB 687 (Chapter 91, Statutes of 2004) proposed to repay \$1.214 billion from bond proceeds secured by tribal gaming revenues.

At the time of this analysis, the timing for sale of the bonds is uncertain due to litigation that has been filed against the state. The 2005-06 Budget assumes that the bonds will be sold in the spring of 2006. However, there is still one pending lawsuit and one potential appeal. To the extent litigation is not resolved within the next six months, the bond sale would be further postponed to 2006-07.

Public Transportation Account (PTA) “Spill-over” Funds. Current law contains an arcane formula that requires the General Fund to transfer sales tax revenues to the PTA under specified conditions. This transfer is often triggered during periods of high gasoline prices and is used to fund rail and mass transit projects. The Budget retains \$200 million in “spill-over” funds in the General Fund, and transfers \$118 million to the Bay Area Toll Authority for seismic retrofits on the Bay Bridge. This proposal would, in effect, divert monies from public transit projects to the General Fund.

High-Speed Rail. Chapter 697, Statutes of 2002 proposed placing a \$9.95 billion general obligation bond measure (for a high-speed rail system) before the voters in November 2004. Chapter 71, Statutes of 2004 (SB 1169) delayed the vote until November 2006. The Administration proposes to postpone this bond indefinitely. In the meantime, the Governor’s budget proposes total expenditures of \$1.3 million for ongoing support of the High-Speed Rail Authority.

The high-speed rail project is a highly speculative venture that could cost as much as \$14.7 billion, assuming a 20-year term at a financing rate of 5 percent. Furthermore, if ridership revenues are insufficient to cover the operating costs, this project could end up costing taxpayers millions of dollars in annual subsidies.

No Aeronautics Account Transfer to the General Fund. Revenues for the Account are derived from an excise tax on aviation and jet fuel. These funds are typically used by publicly-owned airports to maintain and improve runways. In 2002 and 2003, approximately \$6 million and \$4.8 million, respectively, were transferred from the Aeronautics Account to the General Fund. No Aeronautics Account funds are proposed to be transferred to the General Fund in 2006-07.

Public Safety and Judiciary

Judicial Branch and State Trial Court Funding. The 2006-07 Budget for the Judicial Branch totals \$3.7 billion (\$2.1 billion General Fund). This includes funding of \$3 billion for State Trial Court Funding (\$1.6 billion General Fund). This represents an increase of \$139.7 million (\$224.1 million General Fund) over the adjusted 2005-06 expenditures.

Major proposed adjustments are:

- An augmentation of \$121.9 million as a result of the statutory growth factor that ties operational increases to the State Appropriations Limit.
- An increase of \$18.7 million to address deficiencies in court security.
- \$5.5 million to begin an expansion of 150 judgeships beginning in April 2007. The Budget also assumes 161 judicial officers will be converted to judgeships when the position become vacant, but provides no funding as the automatic increase is expected to pay for the increased costs.

California Highway Patrol. The Budget proposes \$1.6 billion for the CHP in 2006-07, which reflects an increase of \$123.8 million over the revised current year. CHP's budgeted is funded primarily from the Motor Vehicle Account. The Budget includes \$57.1 million for the first year of a five year project to replace the CHP Radio system. The total five year cost of this project will be \$491 million. The Budget also proposes \$33.7 million to add 240 officers, 32 supervising officers, and 38 support staff to support workload associated with the growth of population. The Budget also provides an increase of \$6.4 million to hire 173 staff to increase staffing in communications centers to address increased 9-1-1 calls from cell phones.

Department of Justice. The Budget proposes \$745 million (\$387.2 million General Fund and \$357.8 in various special funds and reimbursement authority) for the Department of Justice in 2006-07, which is an increase of \$51.6 million and 210.3 positions over the revised current year.

Major proposed adjustments are:

- An augmentation of \$6.5 million General fund for new Gang Suppression Enforcement Teams.
- An increase of \$6 million General Fund to create three new California Methamphetamine Strategy CALMS teams.
- A General Fund increase of \$1.3 million for the Special Crimes Unit.
- A \$5 million General Fund increase for workload associated with the DOJ Armed Prohibited Persons System (APPS).
- An increase of \$7.8 million General Fund in 2005-06 and \$7.3 million in 2006-07, and a decrease of \$7.3 million from the DNA Identification Fund to reflect lower revenue projections than anticipated.

Department of Corrections and Rehabilitation. The budgets for the Youth and Adult Correctional Agency Departments, including the Youth and Adult Correctional Agency, the Department of Corrections, the Board of Corrections, the Board of Prison Terms, and the Youth Authority have all been combined into one budget beginning in 2005-06. The Budget proposes \$8.1 billion (\$7.8 billion General Fund, \$241 million in various special funds and reimbursements) and 60,966 positions for the Department of Corrections and Rehabilitation, which is an increase of \$364.2 million (\$378.9 million General Fund) and 2,357 positions over the revised current year. Compared to the Budget Act of 2005 expenditures are projected to grow by \$644.8 million (8.9 percent) General Fund in 2006-07.

CDC's inmate average daily population is projected to increase from 167,630 in 2005-06 to 171,497 in 2006-07, an increase of 3,867 inmates, or 2.3 percent. CDC's current inmate population is approximately 168,000, which is an all time high. The parole average daily population is projected to increase from 115,524 in 2005-06 to 116,220 in 2006-07 an increase of 696 parolees, or 0.6 percent. The fiscal impact of these population increases is \$48.4 million General Fund in 2005-06 and \$123.2 million General Fund in 2006-07. The Budget makes no adjustments for implementation of any inmate or parolee programs as it has in previous years. The continuing growth of the inmate population is having significant impacts on the ability of the Department to safely house the inmate population. While the opening of Kern Valley State Prison has provided some relief, there will continue to be significant population pressures, which has led the Administration to propose new capacity measures. Growth measures proposed in this budget and the Strategic Growth Plan include:

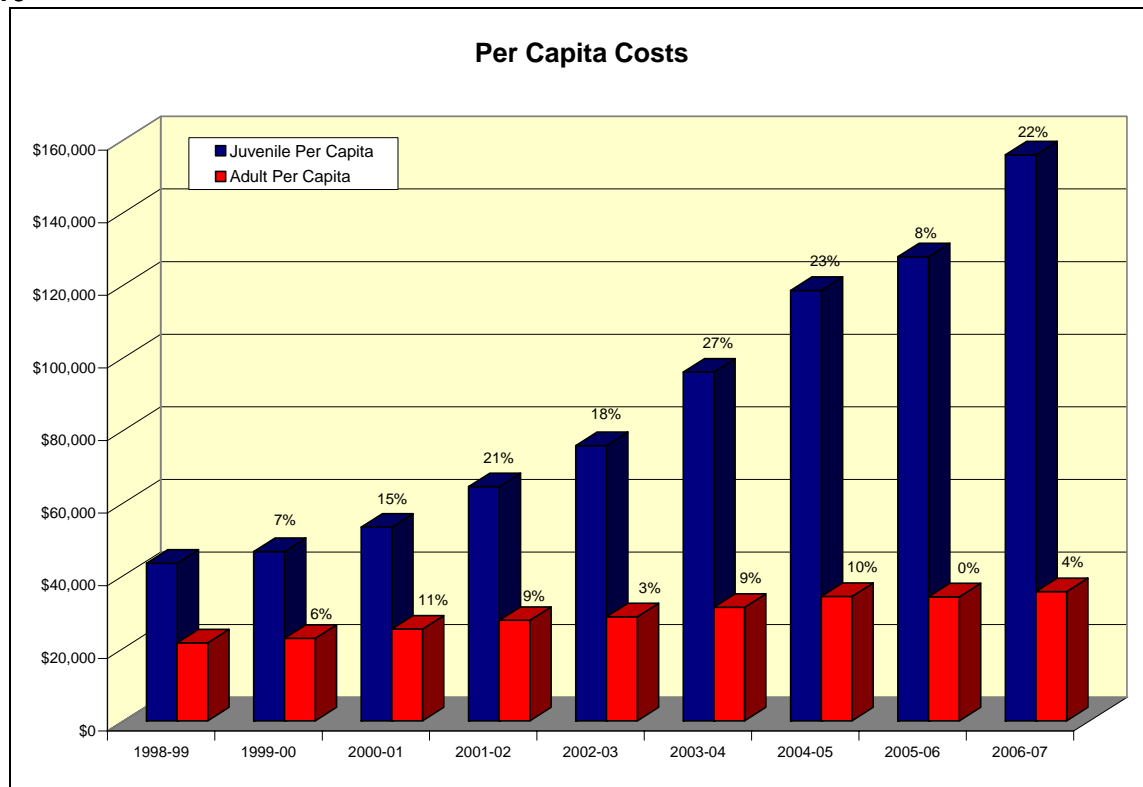
- A proposal to contract with providers to build a significant amount of contracted bed capacity, up to 8,500 beds, including 4,000 male beds, and 4,500 female beds. The proposal for female beds is part of a Gender Responsive Strategy to meet the unique needs of female offenders.
- A \$1.1 billion proposal in the Strategic Growth Plan to build new prisons or juvenile facilities.
- The Strategic Growth Plan also proposes a \$12 billion local jail construction program that would be comprised of \$4 billion of state General Obligation Bonds, \$4 billion in matching local funds, and \$4 billion from local bonds secured by revenues from the state for using local beds.
- An expected Spring proposal for construction of facilities to address inmates in mental health programs, consistent with *Coleman v. Schwarzenegger* litigation. A similar proposal was rejected by the Legislature in the 2005-06 budget process.

The youthful offender (ward) population is projected to decrease from 2,920 on June 30, 2006, to 2,680 by June 30, 2007, a decrease of 240 wards. The parole population is projected to decrease from 3,420 on June 30, 2006, to 3,175 by June 30, 2006, a decrease of 245 parolees.

The cost to house inmates in California prisons and youth facilities continues to escalate. This is in part due to the increasing population for adult inmates, but the per capita costs continue to increase as well. For juveniles this is largely the result of declining population, while at the same time the budget has remained relatively stagnant. For both the adult inmates and juvenile wards, this is also the result of court cases and significant pay increases for correctional staff. The per capita cost for an adult inmate has grown 66 percent to a projected

\$35,587 in 2006-07 from \$21,501 in 1998-99. The growth is even more dramatic for wards, growing 359 percent to a projected cost of \$155,918 in 2006-07 from \$43,410 in 1998-99. For wards the costs will only continue to increase as the settlement to Farrell v. Hickman continues to roll out.

Chart 10



The major proposed adjustments for adult corrections are:

- \$129.9 million General Fund (12.4 percent) for Adult Health Care bringing the total budget to \$1.2 billion, an increase of 105% from \$585.1 million in 2000-01. Given that the court will likely appoint a receiver to take over correctional health care in the near future these costs are likely to continue to increase over the next few years.
 - Includes \$21.5 million for Inmate Dental Services which are also likely to increase significantly over the next few years as the result of litigation.
- \$161.1 million General Fund increase related to previously negotiated compensation increases for CDC employees.
- \$25.4 million in 2005-06 and \$54.5 million in 2006-07 to increase the capacity of the training academy. Significant vacancies have resulted in large increases in overtime usage, and more generous retirement provisions started this fiscal year which could result in more vacancies. The capacity at the academy would be adjusted annually and the Department will explore the option of opening a southern academy.
- The 2005 Budget Act included \$7.5 million for inmate and parolee programs, which was to increase to \$30 million in 2006-07. This Budget includes a total of \$52.8 million in new inmate and parole programs, and is expected to grow to \$95.3 million in 2008-09. In contrast the Budget proposes \$6.3 million for public safety to expand GPS tracking and restoring funding for electronic monitoring. Programs include:

- \$21.1 million for inmate programs;
 - \$7.7 million for community partnerships;
 - \$7.8 million for parolee services;
 - \$9.9 million for institutions rehabilitative and treatment programs;
 - \$6.2 million for research.
- The Budget includes \$85.1 million in 2005-06 and \$11.9 million in 2006-07 to address increased costs for housing parolees in local jails.
 - No savings proposals are included in the Budget including no estimated savings from increasing inmate and parole programs.

The major proposed adjustments for juvenile justice include:

- \$5.1 million General Fund in 2005-06 and \$55 million General Fund in 2006-07 to address the Farrell v. Hickman lawsuit. However, this only includes a portion of the costs of the lawsuit.
- \$5.1 million in 2005-06 and \$55 million in 2006-07 for the Safety and Welfare Plan that changes the core program for juvenile offenders. Phases to be rolled out over the next five years are likely to increase the costs dramatically, and involve opening closed units.
- \$7.5 million to address the health care remedial plan.
- No funding was included for the mental health remedial plan or the education remedial plan, the Administration expects to request funding for these plans in the Spring.

Citizens' Option for Public Safety (COPS)/Juvenile Justice. The Budget proposes \$100 million General Fund for COPS, which provides funding for front-line local law enforcement to hire and retain additional officers and for prosecuting district attorneys. Juvenile Justice Crime Prevention Act funding is restored to \$100 million an increase of \$73.9 million, which was reduced in 2005-06 to reflect the availability of carry over funding. This funding is allocated to local governments for juvenile justice programs.

Booking Fee Subventions. \$40 million General Fund is proposed for booking fee subventions to reimburse local law enforcement jurisdictions that are required to pay booking fees.

Incarceration of Undocumented Felons. The Budget assumes that the state will receive approximately \$114.1 million in federal State Criminal Alien Assistance Program funding for the 2006-07 fiscal year. These federal funds are for the partial reimbursement of the costs associated with the incarceration of the undocumented felon population in prison. The Department of Corrections and the Youth Authority expect to spend approximately \$722.7 million in 2006-07 for the incarceration of undocumented persons.

Commission on Peace Officers Standards and Training (POST). The Budget proposes \$67.5 million in special fund and reimbursements for the Commission in 2006-07, which reflects an increase of approximately \$800,000 over the revised current year.

Resources, Environment and Energy

For 2006-07, General Fund expenditures for resources and environmental protection programs total \$1.6 billion, ***an increase of approximately \$135 million*** over the revised 2005-06 budget. This increase is primarily attributable to the costs for ***levee maintenance and improvements***, and lining the All-American Canal. Fees were a large portion of the budget “solutions” for the 2003-04 and 2004-05 budgets. For 2006-07, the Governor’s budget proposes fee increases totaling \$22 million in the resources and environmental protection programs. Also, separate from the 2006-07 Budget, but included in the Governor’s bond proposal is a \$5 billion fee increase (over a 10-year period) on water purveyors to fund CALFED and various water infrastructure. These and other select topics are discussed below.

Fee Increases. Last year, Legislative Republicans were successful in removing most of the fee increases included in the budget bill and related trailer legislation. The ones that remained were either proposed by the Administration, or may be adjusted without Legislative approval. Republicans generally oppose fee increases because such policies tend to impede economic development.

The Governor’s budget for 2006-07 includes approximately \$22 million in fee increases for resources and environmental protection programs as follows:

- **Dam Safety Fees.** The Department of Water Resources currently charges a fee on dam owners and operators to pay for the cost of facility inspections. These fees were increased by \$7.2 million in 2003-04. The budget proposes to increase these fees, beginning in the current year, by \$700,000 to reflect cost of living adjustments. The Administration does not consider this a fee increase because the department has existing authority to increase fees for COLAs.
- **Waste Discharge Permit Fees.** The State Water Resources Control Board currently charges a permit fee for discharges into state land and waterways. This fee is used to support various water monitoring and enforcement activities. The budget proposes to increase fees by \$4 million to backfill a shift of federal funds. Republicans were successful in defeating a similar proposal of \$4.5 million last year. This increase does not require legislation because the Board is authorized to adjust permit fees within a certain price range. For certain permit holders, this proposal would represent a 27-percent fee increase.
- **Water Rights Fees.** The State Water Resources Control Board currently charges a fee on persons with registered water rights claims. Fee revenues are primarily used to enforce judicial rulings regarding water allocations. For 2006-07, the budget proposes to increase fees by \$1.2 million to address application backlog as well as implement an information management system. This would constitute a 15-percent fee increase.
- **Various Environmental Permitting Fees.** The Department of Toxic Substances Control charges a permitting fee for the handling, transport, and disposal of various chemical substances. Fees are primarily used for enforcement activities. The budget proposes to expand the types of entities who would be required to obtain a permit, thus increasing fee revenues by approximately \$5.5 million in 2006-07.

- **Quarterly Railroad Fees.** The Public Utilities Commission currently charges a fee on railroad operators to pay for rail safety inspections. The budget would increase these fees by \$946,000 to fund additional accident investigations, rail inspections, and oversight of rail transit homeland security programs.
- **Telecommunication Ratepayer Fee.** The Public Utilities Commission currently assesses a surcharge on telephone bills to pay for regulatory and enforcement activities against telecommunications carriers. The budget would increase these fees by \$9.9 million to pay for an outreach campaign and improve consumer complaint and resolution processes. This increase could result in as much as a 40 percent increase on some telephone bills.

Governor's Bond Proposal for Water Infrastructure. The Governor's Strategic Growth Plan includes two general obligation bonds totaling \$9 billion for water infrastructure and flood control, of which \$3 billion would be available in 2006 and \$6 billion would be available in 2010. The total \$9 billion would be allocated for the following general purposes:

Water Infrastructure - \$6.5 billion

- Planning for surface water storage, development of water efficiency measures, and water quality improvements.
- Investment in new surface storage reservoirs.
- Research and development of desalination.

Flood Control - \$2.5 billion

- Flood plain mapping.
- Repair and upgrade levees in the Delta and Central Valley regions.
- Various flood control projects

These provisions are proposed in AB 1839 and SB 1166. Also, as part of the infrastructure bond package, the Administration proposes the following:

- Imposition of a fee on retail water purveyors that is estimated to generate \$5 billion over 10 years. Revenues would be deposited into a newly established Water Resources Investment Fund. Two-thirds of the funds would be returned to local agencies to fund integrated regional water projects, and one-third would be retained by the state for statewide water projects.
- Legislative proposals that would facilitate the assessment of fees such as: establishment of a Central Valley Assessment District (similar to provisions contained in AB 1665) to raise money for flood control projects; and an exemption from Proposition 218 requirements. These provisions are proposed in AB 1665 and ACA 13, respectively.

CALFED. CALFED is a consortium of state and federal agencies created to address various inter-related water problems in the Bay-Delta region over the next 30 years. CALFED goals include improving water quality and wildlife habitat, increasing water supply, and reducing flood risks from levees. However, since CALFED began implementing programs and project construction in 2000, federal funding commitments have fallen short.

Last year, CALFED's budget was significantly reduced, pending the development of a 10-year action plan. Such a plan has been developed and includes elimination of the current CALFED Bay-Delta Authority, as well as increased oversight and program management and a refocus of priorities and deadlines. The Governor's budget proposes \$250 million in 2006-07 to continue water supply development and mitigation of Delta ecosystems.

In addition, the Governor proposes a near-term finance plan for CALFED of approximately \$1 billion over the next 3 years. Funding for approximately 75 percent of annual expenditures has already been identified, with the remaining 25 percent to potentially come from water user fees. The Administration indicates that future funding for CALFED and other water infrastructure projects would come from a combination of general obligation water bonds, new fees in the Water Resources Investment Fund, and local and federal funds beginning in the 2007-08 fiscal year.

Levees and Flood Control. Last year, a levee break in the Jones Tract portion of the San Joaquin delta caused millions of dollars in damages. The state responded with financial assistance for levee repair and debris removal. However, as the result of a recent court ruling on the *Paterno v. state of California* case, the state's liability could increase substantially for future levee failures. In response, last year's budget included \$9.7 million General Fund to improve and maintain the Sacramento and San Joaquin Valley flood system, and develop and implement a more comprehensive flood protection plan.

The Governor's budget for 2006-07 includes:

- \$35 million General Fund and 30 new positions for flood control maintenance and improvements; and
- \$41.3 million for construction of six flood control projects on the Sacramento and American rivers.

All-American and Coachella Canals. Consistent with the Quantification Settlement Agreement (QSA), the budget proposes \$84 million General Fund for the lining of the All-American and Coachella canals. The QSA is an agreement between various federal, state, and local agencies to reduce California's use of the Colorado River. Lining of the canals is anticipated to reduce the amount of water that is absorbed into the ground, thereby increasing the supply of water by about 100,000 acre feet.

Business, Transportation and Housing

Department of Housing and Community Development. The Governor's Budget proposes \$477.5 million (\$16.8 million General Fund) for housing and community development (HCD) activities. This represents a decrease of \$176.4 million from the revised 2005-06 budget and \$98.2 million below the 2005 Budget Act. Overall funding is projected to decline primarily due to the timing of major project approvals from Proposition 46 housing bond funds.

Office of Migrant Services Augmentation. The Governor's Budget includes a \$3.4 million General Fund augmentation to continue the Office of Migrant Services (OMS) reconstruction plan to address health and safety standard deficiencies at the state-built OMS centers, which provide housing for farm workers throughout California.

Proposition 46 Update. Proposition 46, the Housing and Emergency Shelter Trust Fund Act passed by voters in November 2002, was the largest housing bond in the nation's history and provided \$2.1 billion for the state's housing needs. As of June 30, 2005, the state had awarded approximately \$1.1 billion to create or provide incentives for more than 76,300 homes and shelter spaces. Allocations are projected to decline in 2006-07, as HCD has been able to accelerate the award of funds and some categories of funding are fully allocated.

Department of Real Estate. The Governor's Budget proposes \$43.3 million, all from non-General Fund sources, and 364 positions for support of the DRE. This represents an increase of \$8.8 million and 40 positions above the revised current year budget. Significant adjustments include:

- **Electronic Licensing Exam.** \$1.3 million and 1 position to replace the current manual real estate salesperson and broker examinations with an automated system. This project will improve services to fee-paying customers of the DRE by reducing the license application process time up to three months.
- **Enforcement Staffing.** \$2.7 million and 33 positions to complete increasing workload related to processing, investigating, and enforcing complaints against real estate agents.
- **Subdivision Processing Staff.** \$406,000 and 4 positions to address increasing and complex subdivision filing workload, and to reduce processing time of subdivision filings. Given daily carrying costs to industry of between \$5,000 and \$10,000 per project, and the current inventory of 6,682 active applications, the impact of processing time reductions to the California homebuilding economy could be significant.

Department of Alcoholic Beverage Control. The Governor's Budget proposes \$49.1 million, which reflects an increase of \$3.7 million above the 2005 Budget Act, including the following significant adjustment:

- **Grant Assistance Program (GAP).** An additional \$1.5 million for the Grant Assistance Program (GAP), which would increase GAP funding to \$3 million in 2006-07. The GAP provides grants to local law enforcement agencies, which enable them to work with ABC enforcement personnel to investigate alcohol retailers who threaten public safety by violating licensing laws, or by allowing illegal activities on their premises. With the additional funding, the number of law enforcement agencies participating in the GAP will increase from 20 to approximately 40.

- The ABC is wholly funded by licensing fees.

Department of Corporations. The Governor's Budget includes \$31.7 million, which reflects an increase of \$1 million above the 2005 Budget Act. Over the past two years, the Department of Corporations (DOC) has implemented operational and efficiency improvements to improve overall performance, including procedures to reduce the processing time to license branch offices of finance companies and to identify unauthorized and illegal charges by mortgage bankers and financial lenders.

- **Audit of Departmental Activities.** The DOC will be the subject of an extensive audit by the Bureau of State Audits in 2006 due to various consumer complaints that originated during prior administrations. The Administration will monitor the audit's progress, and at its conclusion, the Administration will work with the Business, Transportation, and Housing Agency and with the DOC to ensure the DOC can enforce financial services laws and protect the public from fraud.

Office of the Secretary of Business, Transportation, and Housing. The Governor's Budget proposes \$29 million (\$15.6 million General Fund) and 62 positions to support the activities of the Office of the Secretary. This represents an increase of \$3.4 million above the revised current year budget, but does not include the expenditure of proceeds from bonding out existing projects by the California Infrastructure and Economic Development Bank. Significant adjustments include:

- **California Small Business Loan Guarantee Loan Repayment.** The Budget proposes to repay a \$10.7 million General Fund loan to the Small Business Loan Reserve Fund. This repayment, including interest, will enable the program to guarantee approximately 200 more small business loans. This program provides guarantees for loans issued to small businesses by private financial institutions whose loan criteria would ordinarily exclude those businesses from consideration.
- **Expanded Marketing Program (Travel and Tourism Commission).** An additional \$2.7 million General Fund (for a total of \$10 million) to promote California. These funds will be matched by approximately \$15 million from the private sector, for a total promotional marketing program of \$25 million. It is not clear that this proposal will provide equitable benefits between rural and urban areas.

California Film Commission. The Administration continues to support bipartisan legislative efforts to address the economic impact of run-away film production. Long-term revenue projections assume \$75 million in annual tax credits available to production companies to encourage and retain filming in California beginning in 2007-08. This year, the Commission developed and launched a first-of-its-kind online permitting system that reduces paperwork and streamlines the permitting process for filmmakers.

Employee Compensation and Retirement

The Governor's Budget does not include any significant reform proposals to revise the existing public employee benefit and retirement structure. The Budget does include funding for bargaining units, but only those with existing bargaining agreements. The Budget does not include any additional costs for bargaining units with expired or expiring agreements. Currently, 18 bargaining unit agreements either have expired or will be expiring before July 1,

2006. It is likely the Governor's May Revision will include additional expenditures for at least some of these bargaining units.

California Public Employees' Retirement System

State contributions to CalPERS are estimated to be \$2.5 billion (\$1.3 billion General Fund) in 2006-07. This is an increase of \$54 million over the state's contributions in 2005-06. The state's retirement plan is currently actuarially funded at 84.1 percent, a small increase over the previous year.

Last spring, the Board of Directors for CalPERS adopted new "asset smoothing and amortization" policies. As a result of these new policies, the state should be able to avoid dramatic changes in contribution rates experienced from 2000-01 to 2005-06 when state contributions increased by 1,600 percent.

California State Teachers' Retirement System

The state's contribution to the Defined Benefit Program (set in statute at 2.017 percent of teacher salary) for 2006-07 is estimated to be \$482.3 million General Fund. The Defined Benefit Program is actuarially funded at 83 percent.

The state also contributes 2.5 percent of teachers' salary into the Supplemental Benefit Maintenance Account (SBMA) to provide for purchasing power protection for retiree benefits. The state's contribution for 2006-07 is estimated to be \$597.8 million General Fund. It is important to note that there is still a \$500 million General Fund pressure resulting from the state's failure to pay \$500 of the \$558 million owed to the Teachers' Retirement Fund for the SBMA in 2003. The Governor's Budget does not include repayment in the budget year as they are in the process of appealing the recent ruling, but the costs are likely to contribute to the state's ongoing structural deficit in the near future.

Pension Obligation Bonds

The 2005 Budget Act assumed the sale of \$525 million in Pension Obligation Bonds, to be used to offset increasing pension costs. In November 2005, a court ruling found pension obligation bond sales are unconstitutional without voter approval. The Administration is appealing this ruling, but does not assume the sale of the bonds in the budget year.

General Government

Expenditures are proposed to decrease by \$411.3 million, or 15.7 percent. The major adjustments contributing to this decrease include:

- **Minimum Wage.** \$10.3 million to be allocated in a Control Section pending the enactment of legislation increasing the state minimum wage by \$0.50 per hour.
- **State-Mandated Programs.** \$98.1 million for the first year of the required 15-year repayment to local government for reimbursable state-mandated programs for which payments were deferred in years prior to 2004-05.
- **Budget Stabilization Account.** \$460 million for transfer to the Budget Stabilization Account for early retirement of the Economic Recovery Bonds.

Department of Consumer Affairs

The Governor's Budget proposes \$398.5 million (\$800,000 General Fund), an increase of \$13.4 million (decrease of \$32,000 General Fund) above the revised current year budget. Significant adjustments include:

- **iLicensing System.** \$3.7 million and 8.6 positions to establish an iLicensing System that will make online services available to the consumers of all programs overseen by the department. This system will provide increased access and convenience to 2.3 million licensees and applicants.
- **Medical Board of California.** \$3.9 million and 8 positions to implement Chapter 674, Statutes of 2005, which increased license and renewal fees for physicians, and implements recommendations made by the Enforcement Monitor. The Board is funded through fees paid by the licensees.
- **Bureau of Security and Investigative Services (BSIS).** \$1.4 million and 19 positions to implement Chapter 655, Statutes of 2005, which requires proprietary private security officers to register with BSIS and submit to a background check by the California Department of Justice. BSIS is funded through fees paid by licensees.

Employment Development Department

The Governor's Budget proposes \$10.8 billion (\$24.7 million General Fund), a decrease of \$307 million (increase of \$2.6 million General Fund) from the revised current year budget. The decrease is the result of revised unemployment and disability insurance benefit payment estimates. The following significant adjustments are included:

- **Automated Collection Enhancement System.** \$3.1 million (\$2.7 million General Fund) and 14.3 positions to implement the Automated Collection Enhancement System (ACES), which will enhance the department's ability to collect state payroll taxes, including the Personal income tax, by modernizing and automating its revenue collection process.
- **Employment Training Panel.** \$40.3 million for the Employment Training Panel, including a \$5 million augmentation for its employment training contract program. The Panel supports California's economy by ensuring that employers, primarily small businesses, have the trained workers they need to compete in the global economy while providing workers with reasonable wages and secure employment. The Panel prioritizes special economic development initiatives with the objective of retaining and creating high-skilled, high-paying jobs throughout the state.

Department of Industrial Relations

The Governor's Budget proposes \$346.8 million (\$62.6 million General Fund), an increase of \$2.8 million (\$0.7 million General Fund) above the revised current year budget, including the following significant adjustment:

- **Division of Labor Standards Enforcement Collections Unit.** \$600,000 and 4.8 positions to establish a collections unit within the Division of Labor Standards Enforcement, which will actively pursue the collection of fines and penalties from employers found to be in violation of California's labor laws. These collection efforts are estimated to result in additional revenues to the Unpaid Wage Fund and the General Fund.

Commission on State Mandates

The Governor's Budget proposes \$243.4 million (\$241.6 million General Fund), an increase of \$120.7 million General Fund above the revised current year budget, including the following significant adjustments:

- **Local Government Mandate Repayment.** \$98.1 million for the first year of a 15-year payment plan to reimburse counties for mandated costs for which funding was deferred in years prior to 2004-05.
- **Mental Health Services to Special Education Pupils (AB 3632).** \$50 million non-Proposition 98 General Fund as a set-aside in the Commission on State Mandates budget for funding mental health services to pupils.
- **Mandates Unit within the Department of Finance.** \$537,000 in reimbursements from mandate savings and 3.8 positions to establish a unit devoted to addressing issues related to reimbursable state-mandated local programs. The purpose of this unit is to perform policy and legislative analyses, develop policy and processes to improve the mandates system, and ensure fair and equitable payment of costs associated with mandated local programs.

Fair Political Practices Commission

The Fair Political Practices Commission has primary responsibility for the impartial administration, implementation, and enforcement of the Political Reform Act of 1974, as amended by the voters and Legislature. The Governor's Budget includes \$7 million General Fund, which reflects an increase of \$0.9 million General Fund above the revised current year. One significant new proposal includes:

- **Funding for Workload.** \$864,000 General Fund and 13.3 positions to address increasing workload related to the activities of the Fair Political Practices Commission. The funding includes \$700,000 General Fund and 11.6 positions for workload associated with enacted legislation and to begin addressing the funding shortfall addressed in the Commission's recently adopted Strategic Plan. Additionally, \$164,000 General Fund and 1.7 positions are included for workload resulting from recently enacted legislation that places restrictions on lobbying by local government officials after leaving office.

Secretary of State

The Governor's Budget proposes \$77.2 million (\$32 million General Fund), a decrease of \$306.4 million (\$54.1 General Fund) from the revised current year budget. The decreases result from removing expended one-time federal Help America Vote Act funds. One significant new proposal includes:

- **Current Year Funding for Elections.** \$54 million in the current year for special elections costs. Of this amount, \$45 million is for county costs of the special election and \$9 million is for the state costs of the special election. The 2005 Budget Act

provided funds for one statewide election. This funding is necessary to ensure sufficient resources are available for the special election and the June statewide primary election.

Board of Equalization

The Board of Equalization (BOE) administers the sales and use taxes, insurance tax, excise taxes, and various other taxes and fees, and is responsible for valuing and assessing inter-county pipelines and properties owned by railroads, regulated telephone companies, and gas and electricity sellers. The Governor's Budget proposes \$370.6 million (\$212.8 million General Fund) and 3,208.9 positions for a decrease of \$8 million from the revised current year, including the following major adjustments:

- **Retail Licensing Enforcement.** \$1.6 million (\$1.1 million General Fund) and 13.8 positions to identify and register businesses that fail to pay sales and use taxes on the goods and services these businesses provide. The BOE estimates these enforcement efforts will generate \$12.6 million in additional sales and use tax revenues in 2006-07, of which \$7.9 million will go to the General Fund.
- **Agricultural Inspection Station Leads.** \$1.4 million (\$811,000 General Fund) and 15.1 positions to identify property brought into the state without the payment of applicable sales and use taxes. The program will be run from California Department of Food and Agriculture (CDFA) border inspection stations, through which all commercial vehicle traffic must pass. The BOE estimates the program will generate \$7.4 million in additional sales and use taxes in 2006-07, of which \$4.2 million will go to the General Fund.
- **Out-of-State Tobacco Purchases.** \$1.9 million (\$216,000 General Fund) and 19.5 positions to identify entities, primarily large retailers who purchase tobacco products for resale over the Internet, that purchase tobacco products from out-of-state retailers without paying applicable California sales and use taxes. The BOE estimates the program will generate \$33.8 million in additional revenues in 2006-07, of which \$3.9 million will go to the General Fund.
- **International Fuel Tax Agreement Interim Program.** \$1.1 million in federal funds and 11.5 positions to temporarily maintain the International Fuel Tax Agreement (IFTA) accounts for Mexican motor carriers who will begin operating in the state pursuant to the North American Free Trade Agreement. Under this proposal, the BOE will use federal funds to maintain IFTA records for Mexican carriers until Mexico is able to perform this service itself.

Office of Homeland Security. Currently the Office of Homeland Security is included in the budget for the Office of Emergency Services. The Governor's Budget proposes to budget the Office of Homeland Security as a separate entity beginning January 2007 if legislation is passed establishing the office in statute. The Budget proposes \$183.1 million (Federal Funds and Antiterrorism Fund) in 2006-07.

Office of Emergency Services. The Budget proposes \$1.1 billion (\$124.6 million General Fund, the remainder Federal Funds and other special funds) for the Office of Emergency Services. This reflects a reduction for budgeting the Office of Homeland Security as a separate entity beginning January 2007. The Budget proposes \$6 million in funding for local law enforcement for Sexual Assault Felony Enforcement (SAFE) throughout the state.

Military Department. The Budget includes \$111.5 million (\$38.1 million General Fund and \$73.4 million in various other special funds and reimbursement authority) for a net reduction of \$1 million from the revised current year. The budget includes an augmentation of \$3.5 million (\$3.0 million General Fund) for maintenance and repairs at armories statewide, and \$182,000 1.9 positions to establish and Internal Control Office.

California Victim Compensation and Government Claims Board (Board). The Board's primary role is to compensate victims of violent crime for certain crime-related financial costs. Compensation for the victims comes primarily from the Restitution Fund; and, the two major sources of revenue to the Restitution Fund are penalties on felony convictions and federal funds. The Budget proposes \$136.2 million in 2006-07 which is a decrease of \$1.6 million from the revised current year.

California Gambling Control Commission. The Budget proposes \$137.4 million (\$96.5 million Indian Gaming Revenue Share Trust Fund, \$37.3 million Indian Gaming Special Distribution Fund, and \$2.8 million Gambling Control Fund) and 68.4 positions for the California Gambling Control Commission. State Operations funding totals \$10.9 million, which is an increase over the revised current year by \$3.6 million.

State Aid to Local Government

Elimination of ERAF Payments

Chapter 211, Statutes of 2004, required local governments to shift an additional \$1.3 billion in property tax revenues to the Educational Revenue Augmentation Fund (ERAF) in both 2004-05 and 2005-06. The elimination of these shifts in 2006-07 will mean additional property tax revenues of \$350 million for both cities and counties, \$350 million for special districts, and \$250 million for redevelopment agencies.

ERAF I and II payments are also eliminated for most local governments in 2006-07, primarily due to the continuing shift of additional property taxes to local governments to offset the loss of the Vehicle License Fee. It will also offset the loss of sales tax revenues as a result of the Economic Recovery Bonds.

Sales Tax Revenue

The Governor's Budget estimates that cities will receive an additional \$13 million in sales tax revenues, and that counties will receive an additional \$5 million in such revenues, as a result of the enhanced sales tax collection efforts proposed in the Board of Equalization's budget.

Disaster Relief Funding

The Governor's Budget proposes \$1.6 million in disaster relief funding to backfill property tax revenues lost by local governments due to various natural disasters. These funds are provided in accordance with Chapters 622, 623, and 624, Statutes of 2005.

Property Tax Administration Program Grants

Pursuant to an agreement with the Legislature as part of the 2005 Budget Act, the Governor's Budget proposes to continue the suspension of the Property Tax Administration Program (PTAP) grants through 2006-07, for a General Fund savings of \$60 million. The PTAP grants

are used by county assessors to enhance their property tax collection efforts. The Governor's Budget also indicates that it will work with the Legislature and with local government representatives on alternatives for creating a new PTAP program for implementation in 2007-08.

Statewide Issues

The Statewide Issues Section of the Budget Summary includes issues that affect multiple departments in various major program areas.

Mid-Year Correction Authority

California is only one of twelve states where the Governor may not reduce enacted appropriations without legislative approval. Of the ten most populous states, California's Governor does not have such authority. In order to steady California's reliance on volatile revenue sources such as personal income and capital gains, the Governor's Budget proposes to restore mid-year correction authority similar to that which existed prior to 1983. The mid-year correction authority would allow the Director of Finance to reduce General Fund appropriations if necessary to stay within available resources during a fiscal year. Administrative reductions would be limited to twenty-five percent of the affected appropriation and would require notification to the Legislature within 30 days.

Minimum Wage Increase

The Administration will support legislation to increase the state's minimum wage from \$6.75 per hour to \$7.25 per hour, effective September 1, 2006. This proposal would have a minimal fiscal impact to the state's payroll as only a small number of temporary, seasonal, and contract employees earn less than \$7.25 per hour. It is estimated that a total of \$200,000 General Fund will be needed for the Departments of Forestry and Fire Protection and Parks and Recreation. The California Conservation Corps will have an increase of approximately \$1 million General Fund as a result of increasing the pay for corps members.

Also benefiting from the minimum wage increase will be some non-state employees working in Health and Human Services programs whose compensation costs are directly funded through grants and other subventions to local service providers. The following departments will experience increased costs:

- **The Department of Aging.** Increased costs of \$500,000 General Fund for Senior Community Employment Service, a program that provides subsidized employment to low-income seniors.
- **Department of Social Services.** Increased costs of approximately \$9.2 million (\$3 million General Fund) for the In-Home Supportive Services Program.
- **Department of Developmental Services.** Increased costs of \$8.3 million (\$5.5 million General Fund).

\$150 million General Fund Unallocated Reductions

The Governor's Budget proposes to reduce General Fund spending by a total of \$150 million, comprised of \$50 million in 2005-06 and \$100 million in 2006-07.

In addition to the \$100 million General Fund reductions in 2005-06, as required by Control Section 4.05 of the 2005 Budget Act, the Governor's Budget proposes to reduce General Fund

spending by ***an additional*** \$50 million on a one-time basis in 2005-06 and by \$100 million on a one-time basis in 2006-07.

\$58 million General Fund Reductions to Salaries and Wages Budget

The Governor's Budget proposes to reduce 2006-07 General Fund spending by \$58 million, an amount equivalent to ***one percent*** of 2005-06 General Fund salaries and wages budget. The Administration is not proposing to reduce individual employee's salaries, but rather reduce departmental salaries and wages expenditures ***primarily through vacancies***. Reductions in expenditures on staff benefits and operating expenses and equipment associated with savings in salaries and wages expenditures may be applied towards this amount. These reductions would not apply to the Legislature, the Judicial Branch, Higher Education, or the Governor's Office.

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